

SUMMARY

Uniform Assignment of Rents Act

When a creditor takes a mortgage on rental property (whether residential, commercial or industrial), does that creditor have a protected interest in the rent (income) from that rental property in the event the debtor/owner of the property defaults on the mortgage? The answer is generally and surprisingly no. Usually a mortgagee (the creditor) takes a separate assignment of rents from the mortgagor (debtor), which provides a direct right to rent payments to the mortgagee in the event of a default. But even then, the right to payment is uncertain against other competing creditors. What happens if the tenant pays the mortgagor without notice of the assignment and the mortgagee subsequently demands another payment is not clearly set out. This may put tenants in the untenable position of having to pay twice. Given the sophistication of modern real estate transactions it is a surprise that there is so much uncertainty about this ancillary, though important issue.

For that reason, the Uniform Law Commissioners promulgated the Uniform Assignment of Rents Act (UARA) in 2005. It provides basic rules that establish the “security interest” of the creditor, the rights of tenants to notice and the effect of notice, and the priority of the security interest against other creditors.

The term “security interest” is derived from commercial secured transactions law under Article 9 of the Uniform Commercial Code. A creditor’s security interest attaches to specific collateral that the creditor may possess in the event of a default on the debt. It “arises by agreement and secures performance of an obligation.” UARA provides that a “security instrument” (a mortgage, deed of trust, etc.) creates an assignment of rents unless the instrument expressly excludes such an assignment. Further, the assignment of rents creates a “presently effective security interest” which the creditor may then perfect. “Perfection” is another term derived from commercial secured transactions law. It occurs under UARA when a security instrument is registered/filed in the pertinent real estate records. Perfection provides priority in the collateral. That is, as of the date registered/filed, the security interest has priority over any unperfected security interests or security interests that are perfected by registering/filing after that date.

The effect is to make it clear that any mortgage, deed of trust or the like that provides a creditor an interest in a piece of real estate will also provide a security interest in the rental income of that property, all enforceable in the event there is a default on the debt.

An assignee of rents may obtain direct payment of rents from tenants by providing notice. UARA has specific informational provisions and a statutory form for notice that meets the informational requirements. Once notice is received, the tenant must pay the rent to the assignee. Any payment to the assignor will risk the obligation of double payment, unless the tenant occupies the rented premises as a primary residence. A copy of the notice to a tenant must also go to the assignor.

If more than one assignee gives a tenant notice, the tenant must always honor the latest notice provided. The tenant is not obligated to sort out any disputes over priority of the security interest in the rents.

Enforcement of a perfected security interest in rents may occur in two other forms. The assignee may petition for the appointment of a receiver in the event the assignor has consented or the assignee has been made insecure about enforcement of the security interest. The receiver then takes care of obtaining the rents. The second method is by notifying the assignor directly. The assignor is then required to pay proceeds of rent collection to the assignee directly.

UARA provides a remedy for the existing insecurities involved in obtaining a security interest in rents when a debtor defaults on a real estate obligation. Its uniform enactment in the states will be a boon to interstate real estate markets and it should be enacted in every state as soon as practicable.