

**THE PROPOSED TEXAS ASSIGNMENT OF RENTS ACT:
A LEGISLATIVE ESCAPE FROM THE COMMON LAW MORASS**

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**THE PROPOSED TEXAS ASSIGNMENT OF RENTS ACT:
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When a loan is secured by a mortgage or deed of trust on an income-producing property, such as an office building, shopping center, or apartment complex, rents are a significant part of the security for the loan, in addition to the land and improvements.² Rents provide the funds necessary to pay for operating and maintaining the mortgaged property and to make payments on the mortgage loan.³ After a default on the mortgage loan, a borrower, facing the possibility of losing the property to foreclosure, may apply rents to purposes unrelated to the property or the mortgage loan.⁴ The lender, on the other hand, wants rents collected after default to be applied to operation and maintenance of the property or to the mortgage debt.⁵ Therefore, a lender wants the ability to control rents from mortgaged property in the event of a default, and to this end will require the borrower to execute an assignment of rents at the loan closing. Unfortunately, the law governing assignments of rents is illogical and confusing.⁶

Because of problems in many states with the common law relating to assignments of rents, the National Conference of Commissioners on Uniform State Laws (NCCUSL) appointed a drafting committee in 2003 to draft uniform legislation governing assignments of rents,⁷ and NCCUSL approved the Uniform Assignment of Rents Act (UARA) in 2005.⁸ In early 2009, the Real Estate, Probate, and Trust Law Section (REPTL) assembled a committee to study UARA and adapt the Act to Texas law.⁹ In May 2010, the committee completed drafting of the proposed Texas Assignment of Rents Act (TARA), which is attached as Appendix A. TARA was approved by REPTL and by Texas State Bar leadership and is included in the State Bar legislative package for 2011. TARA would be a vast improvement over current Texas law. This Article explains the problems under current law and describes this legislative escape from the morass of existing common law.

I. The Nature of Rents and Security Interests in Rents

The right to rents from real property is an interest in land incident to the landlord's reversion.¹⁰ Rents are severed from the real property and become personal property when they are actually collected from tenants.¹¹ The right to collect rents is part of the bundle of property rights covered by a mortgage. Because Texas is a lien theory state, the borrower retains the right to possession of the property until completion of a foreclosure.¹² Furthermore, unless the lender has an assignment of rents that permits the lender to collect rents upon default, the borrower has the right to collect rents until the lender forecloses.¹³

Texas law recognizes two types of assignments of rents made in connection with a mortgage loan. Under a collateral assignment of rents, the borrower has the right to collect rents until the lender, after the borrower's default, takes some affirmative action, such as taking possession of the mortgaged property, impounding the rents, obtaining the appointment of a receiver, or taking another similar action.¹⁴ Lenders typically prefer a second type of assignment of rents called an absolute assignment of rents, which purports to actually transfer title to rents to the lender.¹⁵ The absolute assignment usually provides that the borrower may collect rents until default, often based on a license from the lender, but the borrower's right to collect rents terminates automatically and immediately upon the borrower's default. This Article addresses the deficiencies of collateral assignments of rents, the confusion caused by absolute assignments of rents, and TARA as a legislative solution to the problems.

II. Deficiencies of the Collateral Assignment of Rents

In Texas, a collateral assignment of rents will not accomplish most lenders' objectives because of problems relating to perfection and enforcement. With regard to perfection, Texas has adopted the traditional view that a collateral assignment of rents is not perfected until the lender takes an affirmative action to enforce the assignment of rents.¹⁶ In *Taylor v. Brennan*, the Texas Supreme Court held that a collateral assignment of rents is inchoate and "does not become operative" until the lender enforces it.¹⁷ As a result, in a priority contest between a mortgage lender with a recorded but unenforced assignment of rents and a judgment lien creditor who has served a writ of garnishment on rents, the judgment lien creditor will win.¹⁸ The Court of Appeals for the Fifth Circuit, in criticizing the common law approach, stated: "This leads to a bizarre result: A mortgagee, which has done all it could to secure its interest in the rents, loses priority to a judgment

* Portions of this article are adapted with permission from Julia Patterson Forrester, *Still Crazy After All These Years: The Absolute Assignment of Rents in Mortgage Loan Transactions*, 59 FLA. L. REV. 487 (2007). I wish to thank Rick Spencer for his comments on drafts of this Article and SMU law students, Susan Fisher and Blake Redwine, for their research assistance.

creditor who had constructive knowledge by the recordation of the mortgagee's assignment of rents.”¹⁹ An absolute assignment of rents, on the other hand, is perfected when it is recorded and is effective upon default without any requirement that the lender take further action.²⁰

Enforcement of a collateral assignment of rents in Texas requires the lender to take some burdensome action. The lender must “obtain[] possession of the property, or impound[] the rents, or secure[] the appointment of a receiver, or take[] some other similar action.”²¹ However, becoming a mortgagee in possession or obtaining a receiver may be undesirable remedies for a lender. If a lender becomes a mortgagee in possession, the lender faces potential liability to the borrower for mismanagement if the lender fails to meet the standard of a “prudent” or “provident” owner,²² or to third parties for injuries caused by dangerous conditions on the property.²³ If a lender obtains the appointment of a receiver, the lender risks being deemed to have elected a judicial foreclosure as its remedy.²⁴ On the other hand, an absolute assignment of rents gives the lender the right to rents automatically upon default without the necessity for taking any risky or burdensome action.²⁵ Although absolute assignments of rents resolve the concerns that lenders have with collateral assignments of rents, they raise a whole new set of issues.

III. Problems Caused by the Absolute Assignment of Rents

A. Effect of the Absolute Assignment of Rents

The absolute assignment of rents causes confusion because the assignment purports to be a sale of the rental stream rather than the creation of a type of security interest in rents. The Texas Supreme Court created confusion in Texas law when the court said in *Taylor v. Brennan* that an absolute assignment of rents is one which “passes title to the rents.”²⁶ Courts that treat the absolute assignment of rents as a sale of the rental stream rather than as a type of security interest because of the form and language of the document are elevating form over substance and have been routinely criticized by commentators.²⁷

The Court of Appeals for the Fifth Circuit in *FDIC v. International Property Management, Inc.*, has acknowledged that an absolute assignment does in fact create a security interest, albeit a different type of security interest from a collateral assignment of rents.²⁸ The court said that “[t]he concept of a present transfer of title to rents contingent upon default, as opposed to a security interest in the rents, is essentially a legal fiction.”²⁹ An Illinois bankruptcy court made the same point in a more humorous manner, stating, “[The lender] can call this arrangement an ‘absolute assignment’ or, more appropriately, ‘Mickey Mouse.’ It’s still a lien.”³⁰

In other contexts, courts recognize the substance of a transaction as a security interest even if it purports to take another form. For example, the parties to a mortgage loan transaction may document that transaction as a sale of the property rather than as a mortgage.³¹ Sometimes an unsophisticated borrower in desperate need of credit will give a lender an absolute deed to property to secure a loan.³² The parties typically agree that the lender will return the deed unrecorded upon repayment of the debt.³³ In determining the substance of the transaction, courts consider a number of factors, including whether a debt exists, whether the grantor retained possession of the property, whether a disparity exists between the value of the property and the consideration, and whether the parties agree to a reconveyance.³⁴ Courts permit the introduction of parol evidence to prove the true nature of the transaction.³⁵ If a court determines that the substance of such a transaction is in fact a mortgage rather than a transfer of title, the court will treat the deed as a mortgage on the property. Therefore, in the context of the absolute deed intended as security, courts have been able to look beyond the form of the transaction to determine its substance.

The courts holding that an absolute assignment creates a type of security interest are correct because of the true substance of the assignment of rents in the context of a mortgage loan. The substance of the transaction is a security interest for a number of reasons. First, an absolute assignment of rents is given in connection with (and only because of) the related mortgage loan. Second, the borrower is typically permitted to collect rents prior to default. Although the borrower may be required to apply rents to pay for operation and maintenance of the property and to pay debt service, the borrower's use of excess rents is not restricted. Third, the lender is not entitled to collect rents until after a default. Fourth, the rents that the lender collects must be applied to the indebtedness or for expenses related to the mortgaged property. The lender cannot use rents to pay its stockholders a dividend, to give its employees a raise, or to redecorate its offices. Fifth, the borrower retains the risk of nonpayment of rents by the tenants. If a tenant fails to pay rent, the debt is not reduced. Finally, the absolute assignment of rents terminates on payment in full of the debt. After the debt is paid, the “lien” on rents must be released, and the borrower may collect them unencumbered by any obligation to the lender. All of these factors point to the fact that the absolute assignment is actually a security interest.

Theoretically, a property owner could sell the right to collect rents from the property apart from any mortgage. In a true sale of rents, the purchaser would give some consideration for the purchase. Rents are very rarely transferred in a true

sale, however, because the property owner/landlord of necessity retains the obligation to perform under the leases. Without the rental stream, a landlord would have little incentive to perform its duties under the leases. If the landlord stops performing, the tenants are likely to stop paying rent. Thus, rents are not a particularly desirable receivable for a prospective purchaser.

A mortgage lender, on the other hand, has every reason to want an assignment of rents as an incident to its mortgage, and the lender has an incentive to maintain the rental stream and the value of the real property that is security for its loan. This assignment is not a transfer of title at all, but is actually a transfer of a security interest in the rents. The superior treatment of the “absolute assignment” type of security interest gives the lender an incentive to call its security interest an absolute assignment rather than a collateral assignment. However, the confusion over the effect of absolute assignments has created problems in their creation and in their treatment by the courts.

B. Creating an Absolute Assignment of Rents

The uncertainty over whether an absolute assignment of rents creates a security interest or transfers title to rents has made it difficult to create. Texas courts have been reluctant to find that a borrower and lender intended an absolute assignment and, therefore, have required the parties to clearly express their intent.³⁶

If an assignment of rents provides that it is given “as security” or “as additional security” for the mortgage debt, courts will hold that it is not an absolute assignment.³⁷ In *Taylor v. Brennan*, the assignment of rents provided: “[I]n order to further secure the payment of the indebtedness of the Borrower to the Lender, . . . the said Borrower does hereby sell, assign, transfer and set over unto the Lender all of the rents, issues and profits of the aforesaid mortgaged premises.”³⁸

The court held that the document thus showed an intent to create a pledge of rents rather than an absolute assignment.³⁹ Language in an assignment of rents requiring the lender to take some action after default in order to collect rents is also fatal to the finding of an absolute assignment.⁴⁰ In 2006, a bankruptcy court in Texas considered an assignment of rents clause that stated: “[P]rior to Lender’s notice to Borrower of Borrower’s breach of any covenant . . . , Borrower shall collect and receive all rents . . . as trustee for the benefit of Lender and Borrower. This assignment of rents constitutes an absolute assignment”⁴¹ The court concluded that the assignment of rents was a collateral assignment because it made the lender the sole beneficiary of rents only after the lender gave notice of default.⁴²

The elevation of form over substance has made drafting difficult for lenders and their attorneys attempting to secure a loan with an absolute assignment that passes title to the rents upon default and is not “security” for the loan. Because of the pretense involved in creating an absolute assignment of rents, lenders still struggle with these drafting issues, thus incurring additional transaction costs. Lenders and borrowers still spend money litigating these issues, and courts use scarce judicial resources in hearing these disputes. Borrowers and lenders should be able to create a sensible security interest in rents to secure a mortgage debt.

C. State Law Consequences of Confusion over Characterizing an Absolute Assignment of Rents

Confusion over the characterization of an absolute assignment of rents has also been a source of unnecessary litigation. Furthermore, the characterization of an absolute assignment of rents as a transfer of title to rents can have negative consequences for both borrowers and lenders. The negative consequences arise for lenders primarily under state law and for borrowers primarily in bankruptcy.

Of particular concern to lenders are a few cases that imply that a lender who takes an absolute assignment of rents has reduced the amount of the debt in payment for the rental stream without ever actually collecting any rent.⁴³ The confusion arises from language in *Taylor v. Brennan* that an absolute assignment of rents is a *pro tanto* payment of the obligation.⁴⁴ The term *pro tanto* means “to that extent” or “as far as it goes”⁴⁵ and should be interpreted to mean that the debt is reduced to the extent that rents are collected and applied because an absolute assignment is in substance a security interest rather than a sale of rents. However, the risk that a court might hold otherwise creates a concern for lenders.

Other problems for lenders arise when a tenant tries to treat the lender as the landlord based on a misunderstanding of the absolute assignment of rents. In 1990, a tenant sued a lender for breaches under a lease that occurred prior to the lender’s foreclosure.⁴⁶ The tenant claimed that the lender’s absolute assignment of rents placed the lender in privity of estate with the tenant and therefore obligated the lender to comply with lease covenants.⁴⁷ The court did not decide whether the assignment of rents created “only a pledge or an absolute assignment.”⁴⁸ Instead, the court looked to a provision in the assignment of rents stating that the assignee was undertaking no obligation under the lease.⁴⁹ Based on that provision, the court held that the lender was not liable.⁵⁰ Therefore, the court reached the correct result, but incorrectly implied that a

finding of an absolute assignment without any special language abrogating assignee liability would be relevant in determining whether the lender was liable.

Ten years later, in a suit by a landlord against a tenant for breach of lease, the tenant argued that the lender was a necessary party in the suit because of an absolute assignment of rents.⁵¹ The court looked to the provisions of the assignment of rents that granted the borrower the right to collect rents until the lender gave notice of default.⁵² Because the lender never gave notice of default, the court held that the borrower retained the right to bring or defend a suit under the lease and, therefore, that the lender was not a necessary party to the suit.⁵³ Once again, the court reached the right result, but the court incorrectly implied that a lender with an absolute assignment of rents could be treated as a party to the lease after default under the terms of the mortgage. Thus, although the absolute assignment of rents has served lenders in providing a type of security interest that avoids some of the pitfalls of the collateral assignment of rents, it has caused needless litigation and confusion. This uncertainty has carried over into bankruptcy cases in which it has caused significant problems.

D. The Absolute Assignment of Rents in Bankruptcy

The confusion regarding characterization of an absolute assignment of rents as a transfer of title or a security interest has created uncertainty in bankruptcy cases as well as under state law. Federal courts are split on the treatment of an absolute assignment of rents when the debtor is in bankruptcy. Most courts addressing the issue in the bankruptcy context have held that an absolute assignment gives a lender only a security interest in rents.⁵⁴ These courts recognize the continuing interest of the bankruptcy estate in rents covered by an absolute assignment and have held that the rents covered by a duly recorded absolute assignment of rents are cash collateral.⁵⁵

However, other federal courts have treated an absolute assignment of rents as giving the lender an absolute ownership interest in rents.⁵⁶ These courts have held that because the lender owns the rents absolutely as a matter of state law, the bankruptcy estate has no interest in the rents.⁵⁷ Therefore, the bankruptcy trustee or debtor-in-possession has no right to use the rents to operate and maintain the property in a reorganization.

Bankruptcy courts that hold that an absolute assignment of rents gives a lender ownership of rents rather than a security interest are simply incorrect. Although the form of the transaction may indicate a transfer of title to rents, the substance of such a transaction is a security interest. Some of these courts are following state law precedent on the theory that property rights are a matter of state law.⁵⁸ The better-reasoned bankruptcy opinions look to the substance of the transaction and to factors such as the borrower's right to collect rents until default, the lender's obligation to apply rents to payment of the debt, and the termination of the assignment of rents upon payment of the loan.⁵⁹ If the borrower has any remaining property rights in the rental stream under state law, bankruptcy law dictates that the rental stream be treated as part of the bankruptcy estate.⁶⁰

When a court holds that rents covered by an absolute assignment are owned by the lender, the debtor-in-possession does not have any rents available for operation and maintenance of the mortgaged property as would be the case if rents were treated as cash collateral.⁶¹ If rents are unavailable for operation and maintenance of the property, almost no hope of reorganization exists for a borrower in Chapter 11.⁶² If the debtor has no equity in the property and there is not "a reasonable possibility of a successful reorganization within a reasonable time,"⁶³ the lender is entitled to relief from the automatic stay.⁶⁴ Therefore, the borrower's efforts to reorganize under the protection of Chapter 11 will be frustrated even in those cases where a reorganization might otherwise have been successful.⁶⁵ This result defeats the policies behind the Bankruptcy Code and Chapter 11.

IV. A Legislative Solution to the Problem

The absolute assignment of rents is not a satisfactory method of creating a security interest in rents. It causes problems for lenders in drafting and enforcing the assignment of rents and for borrowers in bankruptcy. It causes unnecessary litigation that may raise the cost of credit. However, because it is the best alternative for lenders at this time, it cannot simply be eliminated unless replaced by a workable solution to the problems it solves. Therefore, comprehensive change is

necessary. This change has occurred gradually in some states through the judicial process, but the legislative process provides a faster and more comprehensive solution. The proposed Texas Assignment of Rents Act (TARA or the Act) provides that legislative relief. TARA has been approved for inclusion in the Texas State Bar legislative package to go to the legislature in 2011.

The REPTL committee that drafted TARA began with UARA, but made numerous and substantial changes. Thus, TARA is not the uniform act. In addition, TARA does not include the official comments to UARA.⁶⁶ However, this author finds some of the comments to UARA helpful in understanding some sections of TARA.

A. Preliminary Matters

Preliminary sections of TARA provide for a short title, definitions, and manner of giving notifications under the Act.⁶⁷ Section 2 of the Act contains definitions of terms. The Act uses the terms “Assignee” and “Assignor,” as defined therein, for the lender and the borrower, respectively,⁶⁸ and this article will use those terms in discussing the Act. Under the Act, an “Assignment of Rents” is “a transfer of an interest in rents” made in connection with a mortgage loan.⁶⁹ The definition expressly excludes net profits interests that are permitted under Section 306.101 of the Texas Finance Code,⁷⁰ pursuant to which an assignment of rents could be given as additional consideration for a qualified commercial loan.⁷¹ The definition also excludes the rare true sale of rents where the substance of a transaction is the sale of an income stream rather than a device to secure payment of a mortgage loan.⁷² One committee member gave as an example of a true sale a transaction in which a landowner sold the right to receive cell tower rents to a purchaser. The Act would not cover that true sale of rents.

The definition of rents as “consideration payable for the right to possess or occupy . . . real property”⁷³ is very broad and includes payments made by a licensee, such as hotel room revenues and parking fees. Correspondingly, the definition of tenant⁷⁴ includes licensees and is thus broader than the term as it is used in Title 8 of the Property Code dealing with landlord and tenant.⁷⁵ Finally, for consistency, several of the definitions in TARA reference other Texas statutory definitions, including the definition of “person,” “security instrument,” and “sign.”⁷⁶

Because notification is the primary method of enforcing an assignment of rents under TARA,⁷⁷ the committee gave a great deal of attention to the notification provisions of the Act. The Act provides the method of notification and the addresses to which notification may be given.⁷⁸ Provisions regarding addresses for notification to a tenant were particularly difficult to draft because the assignee does not always have an agreement with a tenant that provides an address for notice. Because notifications are so important under the Act, assignees and tenants will benefit from having an agreement as to notifications.⁷⁹ TARA provides that notification is deemed to be received on actual receipt, five days after notification is given, or as otherwise agreed.⁸⁰

B. Creation and Perfection of a Security Interest in Rents

The primary substance of TARA is in sections 4 through 8, which provide for creation, perfection, and enforcement of a security interest in rents.

Section 4(a) changes present law by providing that a deed of trust, mortgage, or other contract lien on land assigns rents from that land unless it specifically provides otherwise.⁸¹ Thus, under the Act, every deed of trust would be an assignment of rents unless it specifically provides that is not. Because rents are proceeds of the real property, this provision simply ensures that a lender has a security interest in proceeds from its collateral. This section might raise a concern in the context of residential mortgagors; however, that concern is addressed in the Act by limitations placed on remedies against a homeowner.⁸² Essentially, a residential lender would have an assignment of rents under the Act, but it could not be enforced against the homeowner. Section 4(a) provides an exception for home equity loans, home equity lines of credit, and reverse mortgages, which are not permitted under the Texas Constitution to have any security other than the homestead.⁸³

Section 4(b) provides that an assignment of rents, including an absolute assignment, creates a security interest regardless

of its form.⁸⁴ Because TARA provides for a workable security interest in rents for mortgage lenders with due regard for the concerns of borrowers and tenants, it eliminates the need for an absolute assignment of rents.

Section 4(c) is a special Texas section (with a special Texas comment) that is designed “to eliminate confusion created by language in *Taylor v. Brennan* . . . to the effect that an absolute assignment of rents is a *pro tanto* payment of the obligation.”⁸⁵ Section 4(c) provides that “[a]n assignment of rents does not reduce the secured obligation except to the extent the assignee collects rents and applies, or is obligated to apply, the collected rents to payment of the secured obligation.”⁸⁶ The Act would eliminate any question that an assignment of rents could operate to reduce the indebtedness in any way other than actual payment.

Section 5 provides that an assignment of rents is fully perfected upon recordation.⁸⁷ The Act further provides that a perfected security interest in rents has priority over subsequent creditors and transferees.⁸⁸ With state law clarified by the Act, a recorded assignment of rents would be treated as perfected in bankruptcy, resolving the perfection problem that lenders tried to avoid by using absolute assignments.

C. Enforcement of an Assignment of Rents Under TARA

TARA has detailed provisions relating to the enforcement of an assignment of rents. Section 6 provides that an assignment of rents may be enforced: 1) under section 7 by notification to the assignor, 2) under section 8 by notification to tenants, and 3) by methods permitted under common law.⁸⁹ Sections 7 and 8 create new methods of enforcement under Texas law that do not require a lender to take burdensome action to enforce an assignment of rents. However, an assignee could still enforce an assignment of rents under *Taylor v. Brennan* by taking possession of the property, impounding rents, or securing the appointment of a receiver.⁹⁰ UARA had an entire section devoted to enforcing an assignment of rents by securing the appointment of a receiver, which the committee deleted.⁹¹ The section would have changed Texas receivership law, which the committee felt was beyond the scope of its mission. Although receivership is relatively rare in Texas, Texas law does provide for enforcement of an assignment of rents by securing the appointment of a receiver,⁹² and section 6 preserves that option.

Section 6 also defines which rents an assignee is entitled to upon enforcement. It provides that the assignee is entitled to rents that “have accrued but remain unpaid” on the date of enforcement and rents that “accrue on or after that date.”⁹³ The assignee is not entitled to proceeds of rents that accrued and were paid before enforcement because those funds may be spent or may be subject to competing claims. An assignee who wants to control those funds can require a lockbox arrangement, or the assignee can require personal liability for the assignor’s misapplication of rents collected before enforcement.

Sections 7 and 8 provide details as to enforcement by notification to the assignor and tenants, respectively. Assignees will almost certainly want to enforce by both methods. Enforcement by notification to the assignor gives the assignee remedies against the assignor to reach proceeds of rents that the assignee collects after enforcement as well as proceeds of prepaid rents that the assignor collected before enforcement. Enforcement by notification to tenants gives the assignee the right to collect rents from tenants after the date of enforcement.

Under section 7, an assignee may give notification to the assignor to turn over proceeds of those rents that the assignee is entitled to collect pursuant to section 6.⁹⁴ Note that the date of enforcement against an assignor is the date of giving the notification.⁹⁵ An assignee may not enforce an assignment of rents by giving notice to the assignor if the mortgaged property covered by the assignment of rents is the assignor’s homestead.⁹⁶ Section 13 makes the assignor personally liable for proceeds and reasonable attorney’s fees and costs if the assignor fails to turn over the proceeds.⁹⁷ This provision is particularly important for the lender if the borrower is not personally liable for the debt because the debt is non-recourse or because the mortgaged property has been conveyed to a non-assuming grantee. Section 14 governs the assignee’s security interest in proceeds, providing that the security interest attaches to identifiable proceeds.⁹⁸ If the assignment of rents is perfected, the “security interest in identifiable cash proceeds is perfected,”⁹⁹ and the security interest in proceeds is otherwise governed by Chapter 9 of the Business and Commerce Code.¹⁰⁰ Therefore, the Act provides a comprehensive scheme for the lender to reach proceeds of prepaid rents and rents collected by the assignor after

enforcement.

An assignee may give notification to tenants to pay unpaid accrued rents and unaccrued rents to the assignee under section 8.¹⁰¹ “The date of enforcement against a tenant is the date on which the tenant *receives* [the] notification.”¹⁰² Section 9 provides a safe harbor form for an assignee to use for the notification, and section 8 requires that the notice substantially comply with that form.¹⁰³

Tenants receiving a notification to begin paying rent to a lender rather than to the landlord are understandably reluctant to do so because of the risk that they may pay the wrong party. Tenants in this position often stop paying rent altogether to avoid paying the wrong party. The Act provides detailed provisions that strongly encourage tenants to pay an assignee who has exercised its rights under an assignment of rents rather than the landlord and at the same time protect the tenants in paying the assignee.¹⁰⁴ Most tenants who pay the assignor after receiving notification will not be discharged from the obligation to pay the assignee.¹⁰⁵ A residential tenant, however, may discharge the obligation to pay rent by paying either assignor or assignee because the committee did not want to put consumers to a difficult and confusing choice.¹⁰⁶

A tenant is not required to pay again any rents prepaid to the assignor unless the tenant has otherwise agreed not to prepay rents.¹⁰⁷ Thus, assignees have an incentive to obtain such an agreement in a document such as a Subordination, Non-Disturbance, and Attornment Agreement.¹⁰⁸ Tenants are given a grace period for payment of rent after receiving a notice so that the tenant may seek the advice of counsel.¹⁰⁹ Finally, section 8 addresses priority issues among assignees by requiring an assignee to cancel its notification if a prior creditor has foreclosed or is enforcing an assignment of rents.¹¹⁰

D. Other Provisions

TARA tries to clarify and define the rights and duties of the parties to an assignment of rents and to resolve in advance the issues that the parties and tenants affected by an assignment of rents might need to litigate. Section 10 provides that the enforcement of an assignment of rents does not “make the assignee a mortgagee in possession of the real property.”¹¹¹ Although most courts have held that collecting rents by giving notice to a borrower or tenants without otherwise taking control of property does not make a lender a mortgagee in possession,¹¹² a few courts have held otherwise.¹¹³ Lenders tend to avoid taking possession of mortgaged property prior to foreclosure to avoid liability, and, therefore, lenders do not want to be liable as a mortgagee in possession simply because they are collecting rent. TARA resolves this issue by providing that the lender does not become a mortgagee in possession simply by virtue of collecting rents.¹¹⁴ Section 10 further provides that enforcement does not make the assignee an agent of the assignor, constitute an election of remedies, make the secured obligation unenforceable, limit any rights of the assignee, or bar a deficiency judgement.¹¹⁵

The Act further provides that the lender is not obligated by virtue of collecting rents to pay “expenses of protecting or maintaining the real property.”¹¹⁶ The assumption is that mortgage lenders have sufficient incentive to pay taxes and insurance premiums and to maintain the mortgaged property if the borrower is unable or unwilling to do so.¹¹⁷ The Act makes clear that if the lender's failure to maintain the property results in a breach of the lease by the landlord, tenants may have a defense to paying rent.¹¹⁸ Therefore, the concerns of tenants, as well as borrowers and lenders, are considered in the Act. Finally, Section 11 provides for the order of application of proceeds,¹¹⁹ and section 15 provides that priorities in rents may be subordinated by agreement.¹²⁰

V. Conclusion

Texas law regarding assignments of rents has been in great disarray. Lenders, dissatisfied with the problems they have encountered with collateral assignments of rents, have turned to the absolute assignment of rents as a solution. The absolute assignment, however, caused substantial confusion. Courts have made drafting an absolute assignment difficult by requiring the pretense of a transfer of title to the rents. Courts have caused additional uncertainty by treating absolute assignments as a transfer of title to rents, when in fact they simply create a different type of security interest. The refusal of courts to give lenders reasonable security interests under collateral assignments and lenders' use of absolute assignments to overcome the deficiencies of collateral assignments have led to additional transaction costs and unnecessary litigation.

The Act considers and balances the rights of borrowers, lenders, and tenants. It would eliminate the need for absolute assignments of rents by creating a workable security interest for lenders and more certainty for both borrowers and lenders. It would therefore reduce transaction costs and litigation caused by this device. The Act would resolve confusion over the perfection of an assignment of rents. In addition, under the Act, lenders could enforce an assignment of rents upon default simply by giving notification to the borrower or tenants. For borrowers, this method of enforcement is no more onerous than rights that lenders have under current law to enforce an absolute assignment of rents. In addition, for the benefit of borrowers, lenders could no longer try to use an absolute assignment of rents to block a borrower's ability to reorganize under Chapter 11 of the Bankruptcy Code. The Act provides a clear and comprehensive scheme for the creation of security interests in rents.

A solution to the problems relating to assignments of rents in mortgage loan transactions is now at hand. The proposed Texas Assignment of Rents Act provides a comprehensive and logical scheme for creating security interests in rents that will satisfy mortgage lenders while considering the needs of borrowers and tenants. It is indeed an escape from the morass.

Endnotes

2. See Julia Patterson Forrester, *A Uniform and More Rational Approach to Rents as Security for the Mortgage Loan*, 46 RUTGERS L. REV. 349, 349-50 (1993).

3. *Id.* at 350.

4. *Id.*

5. *Id.*

6. *Id.*

7. See R. Wilson Freyermuth, *Modernizing Security in Rents: The New Uniform Assignment of Rents Act*, 71 MO. L. REV. 1, 3 (2006).

8. UNIF. ASSIGNMENT OF RENTS ACT (2005), available at <http://www.law.upenn.edu/bll/ulc/maripp/2005Final.pdf>.

9. The committee was chaired by Rick Spencer and included Cary Barton, David Derber, Bill Locke, Paul Pruitt, Ed Walker, and the author.

10. See *Treetop Apartments Gen. P'ship v. Oyster*, 800 S.W.2d 628, 629 (Tex. App.—Austin 1990, no writ).

11. See *id.*

12. See *Taylor v. Brennan*, 621 S.W.2d 592, 593-94 (Tex. 1981).

13. See *id.* at 593; *Treetop*, 800 S.W.2d at 629.

14. *Taylor*, 621 S.W.2d at 594.

15. See *FDIC v. Int'l Prop. Mgmt., Inc.*, 929 F.2d 1033, 1038 n.5 (5th Cir. 1991) (citing *Taylor*, 621 S.W.2d at 594); *801 Nolana, Inc. v. RTC Mortg. Trust 1994-S6*, 944 S.W.2d 751, 754-56 (Tex. App.—Corpus Christi 1997, writ denied).

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16. See *O'Neal Steel, Inc. v. E B, Inc. (In re Millette)*, 186 F.3d 638, 641 (5th Cir. 1999); *Wolters Village, Ltd. v. Village Properties, Ltd. (In re Village Properties, Ltd.)*, 723 F.2d 441, 443 (5th Cir. 1984); *Taylor*, 621 S.W.2d at 594.
 17. *Taylor*, 621 S.W.2d at 594.
 18. See, e.g., *Millette*, 186 F.3d at 642.
 19. *Id.*
 20. See *id.* at 643 (citing *Taylor*, 621 S.W.2d at 594).
 21. *Taylor*, 621 S.W.2d at 594.
 22. *Bomar v. Smith*, 195 S.W. 964, 980 (Tex. Civ. App.—Dallas 1917, no writ); RESTATEMENT (THIRD) OF PROP.: MORTGS., § 4.1 cmt. c (1997).
 23. See GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 4.26 (5th ed. 2007).
 24. See *First S. Props., Inc. v. Vallone*, 533 S.W.2d 339, 341-42 (Tex. 1976).
 25. See *Taylor*, 621 S.W.2d at 594.
 26. *Id.*
 27. See RESTATEMENT (THIRD) OF PROP.: MORTGS. § 4.2 cmt. a (1997); Craig H. Averch et al., *The Treatment of Net Rents in Bankruptcy—Adequate Protection, Payment of Interest, Return of Collateral, or Reduction of Debt*, 48 U. MIAMI L. REV. 691, 709 (1994); David Gray Carlson, *Rents in Bankruptcy*, 46 S.C. L. REV. 1075, 1105-07 (1995); Forrester, *supra* note 1, at 379-81; Freyermuth, *supra* note 6, at 29-35; Patrick A. Randolph, Jr., *Recognizing Lenders' Rents Interests in Bankruptcy*, 27 REAL PROP. PROB. & TR. J. 281, 290 (1992).
 28. *FDIC v. Int'l Prop. Mgmt., Inc.*, 929 F.2d 1033, 1035 (5th Cir. 1991).
 29. *Id.* (citing Patrick A. Randolph, Jr., *When Should Bankruptcy Courts Recognize Lenders' Rents Interests?*, 23 U.C. DAVIS L. REV. 833 (1990)).
 30. *Foundry of Barrington P'ship v. Barrett (In re Foundry of Barrington P'ship)*, 129 B.R. 550, 557 (Bankr. N.D. Ill. 1991).
 31. See, e.g., *Flack v. McClure*, 565 N.E.2d 131, 135 (Ill. App. Ct. 1990); *Johnson v. Cherry*, 726 S.W.2d 4, 6 (Tex. 1987).
 32. See *Flack*, 565 N.E.2d at 135.
 33. See *id.*
 34. See *id.* at 136; *Johnson*, 726 S.W.2d at 7; *Sannerud v. Brantz*, 928 P.2d 477, 481 (Wyo. 1996); RESTATEMENT (THIRD) OF PROP.: MORTGS. §§ 3.2(b), 3.3(b) (1997); NELSON & WHITMAN, *supra* note 22, § 3.8.
 35. See NELSON & WHITMAN, *supra* note 22, § 3.6.

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36. See *FDIC v. Int'l Prop. Mgmt., Inc.*, 929 F.2d 1033, 1036 (5th Cir. 1991).
37. See, e.g., *Taylor v. Brennan*, 621 S.W.2d 592, 594-95 (Tex. 1981). In *FDIC v. International Property Management, Inc.*, 929 F.2d 1033, 1038 (5th Cir. 1991), the Court of Appeals for the Fifth Circuit recognized that all assignments of rents made in connection with a mortgage loan are undoubtedly made to secure the debt, but the court nevertheless stressed the fact that the assignment in that case did not use the words "security" or "pledge" in holding that it was an absolute assignment.
38. *Taylor*, 621 S.W.2d at 594.
39. *Id.* at 595.
40. See, e.g., *In re Allen*, 357 B.R. 103, 112 (Bankr. S.D. Tex. 2006); *Taylor*, 621 S.W.2d at 594-95; *Cadle Co. v. Collin Creek Phase II Assocs., Ltd.*, 998 S.W.2d 718, 723-24 (Tex. App.—Texarkana 1999, no pet.).
41. *In re Allen*, 357 B.R. at 112.
42. *Id.* at 113.
43. See *In re Fry Rd. Assocs., Ltd.*, 64 B.R. 808, 810 n.1 (Bankr. W.D. Tex. 1986); *801 Nolana, Inc. v. RTC Mortg. Trust 1994-S6*, 944 S.W.2d 751, 754-56 (Tex. App.—Corpus Christi 1997, writ denied); Edward F. Walker, *Address at 2010 Annual Meeting of the State Bar of Texas: Proposed Assignment of Rents Act—A First Look 2-4* (June 11, 2010), available at <http://cwrwlaw.com/resources/articles>.
44. *Taylor*, 621 S.W.2d at 594.
45. BLACK'S LAW DICTIONARY (9th ed. 2009); BRYAN A GARNER, A DICTIONARY OF MODERN LEGAL USAGE 708 (2nd ed. 1995).
46. See *Naficy v. Woodmen of the World Life Ins. Soc'y*, No. A14-89-00964-CV, 1990 WL 122128, at *1 (Tex. App.—Houston [14th Dist.] Aug. 23, 1990, no writ) (not designated for publication). As an unreported case, *Naficy* does not create precedent, but it is useful to illustrate the litigation that can result from the use of an absolute assignment of rents.
47. See *id.* at *5.
48. *Id.* at *7.
49. See *id.* at *6.
50. See *id.* at *7.
51. See *Leon's Fine Foods, Inc. v. Merit Inv. Partners, Ltd.*, No. 05-97-005430CV, 2000 WL 1048491, at *2 (Tex. App.—Dallas July 31, 2000, pet. denied) (not designated for publication).
52. See *id.* at *2.
53. See *id.* at *2-3.

54. See, e.g., *In re Amaravathi Ltd. P'ship*, 416 B.R. 618, 637-38 (Bankr. S.D. Tex. 2009), *appeal directly to 5th Cir.*, 2009 WL 2342749 (S.D. Tex. 2009); *In re Allen*, 357 B.R. 103, 115 (Bankr. S.D. Tex. 2006); *In re 5877 Poplar, L.P.*, 268 B.R. 140, 146-47 (Bankr. W.D. Tenn. 2001); *In re Guardian Realty Grp., L.L.C.*, 205 B.R. 1, 4-6 (Bankr. D.D.C. 1997); *Lyons v. Fed. Sav. Bank (In re Lyons)*, 193 B.R. 637, 648-49 (Bankr. D. Mass. 1996); *500 Ygnacio Assocs., Ltd. v. Aetna Life Ins. Co. (In re 500 Ygnacio Assocs., Ltd.)*, 141 B.R. 191, 192 (Bankr. N.D. Cal. 1992); *Foundry of Barrington P'ship v. Barrett (In re Foundry of Barrington P'ship)*, 129 B.R. 550, 556-57 (Bankr. N.D. Ill. 1991); *In re Rollingwood Apartments, Ltd.*, 133 B.R. 906, 910 (Bankr. S.D. Ohio 1991); *In re Bethesda Air Rights Ltd. P'ship*, 117 B.R. 202, 206 (Bankr. D. Md. 1990); see also *FDIC v. Int'l Prop. Mgmt., Inc.*, 929 F.2d 1033, 1035 (5th Cir. 1991).

55. See *Amaravathi*, 416 B.R. at 637; *In re Princeton Overlook*, 143 B.R. 625, 633 (Bankr. D.N.J. 1992); *Rollingwood*, 133 B.R. at 913; *Bethesda*, 117 B.R. at 209, 211.

56. See, e.g., *First Fid. Bank, N.A. v. Jason Realty, L.P. (In re Jason Realty, L.P.)*, 59 F.3d 423, 427 (3d Cir. 1995); *In re Fry Rd. Assocs., Ltd.*, 64 B.R. 808, 809 (Bankr. W.D. Tex. 1986).

57. See *Fry Rd. Assocs.*, 64 B.R. at 809.

58. See *Jason Realty*, 59 F.3d at 427 (citing *Butner v. United States*, 440 U.S. 48, 55 (1979)).

59. See *Amaravathi*, 416 B.R. at 633; *Guardian Realty*, 205 B.R. at 9; *500 Ygnacio Assocs.*, 141 B.R. at 195; *Bethesda*, 117 B.R. at 206; *Bryn Athyn Investors, Ltd. v. Hutton/Conam Realty Pension Investors (In re Bryn Athyn Investors, Ltd.)*, 69 B.R. 452, 457 (Bankr. E.D.N.C. 1987).

60. See 11 U.S.C. § 541(a)(6) (2007); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 208-09 (1983).

61. If rents are cash collateral, the debtor-in-possession may not use the rents without consent of the lender or authorization of the bankruptcy court. See 11 U.S.C. § 363(c)(2). A bankruptcy court may not authorize the use of cash collateral by the debtor unless the secured lender is adequately protected. See *id.* § 363(e). Bankruptcy courts generally permit the debtor to use rents for operation and maintenance of the mortgaged property because that use preserves the value of the property and, thus, provides the lender with adequate protection. See *Forrester*, *supra* note 1, at 388.

62. See Craig A. Averch, *Revisitation of the Fifth Circuit Opinions of Village Properties and Casbeer: Is Post-Petition "Perfection" of an Assignment of Rents Necessary to Characterize Rental Income as Cash Collateral?*, 93 Com. L.J. 516, 519 (1988); *Carlson*, *supra* note 26, at 1109. In a single-asset bankruptcy, the borrower will have no income available to continue operation and maintenance of the mortgaged property. See *Carlson*, *supra* note 26, at 1152-53.

63. *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd. (In re Timbers of Inwood Forest Assocs., Ltd.)*, 484 U.S. 365, 376 (1988) (quoting *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd.*, 808 F.2d 363, 370-71, nn.12-13 (5th Cir. 1987), *aff'd*, 484 U.S. 365 (1988)).

64. See 11 U.S.C. § 362(d)(2).

65. If the lender is treated as the owner of rents under an absolute assignment of rents, rents are not available for operation and maintenance of the property, and the lender is likely to be granted relief from the stay and thus be

permitted to foreclose. See *First Fid. Bank v. Jason Realty, L.P. (In re Jason Realty, L.P.)*, 59 F.3d 423, 430 (3d Cir. 1995); *In re Fry Rd. Assocs., Ltd.*, 66 B.R. 602, 604-05 (Bankr. W.D. Tex. 1986).

66. See *Walker*, *supra* note 42, at 5.

67. See Texas Assignment of Rents Act (TARA) §§ 1-3 (proposed draft 2010).

68. See *id.* § 2(1), (3).

69. *Id.* § 2(2).

70. See *id.*

71. See *Walker*, *supra* note 42, at 6.

72. TARA § 2(2).

73. *Id.* § 2(11).

74. See *id.* § 2(16).

75. See TEX. PROP. CODE ANN. § 92.001(6) (West 2010).

76. See *id.* § 2(9), (13), (15).

77. See *id.* §§ 7, 8.

78. See *id.* § 3(a), (b).

79. See *Walker*, *supra* note 42, at 8.

80. See TARA § 3(c).

81. See *id.* § 4(a).

82. See *id.* § 7(c).

83. See Tex. Const. art. XVI, § 50(a)(6)(H).

84. TARA § 4(b).

85. *Id.* § 4 cmt.

86. *Id.* § 4(c).

87. See *id.* § 5(b).

88. See *id.* § 5(c).

89. *See id.* § 6(a).

90. *Taylor v. Brennan*, 621 S.W.2d 592, 594 (Tex. 1981).

91. *See* UNIF. ASSIGNMENT OF RENTS ACT § 7.

92. *See Taylor*, 621 S.W.2d at 594.

93. TARA § 6(b).

94. *See id.* § 7(a).

95. *See id.* § 7(b).

96. *See id.* § 7(c).

97. *See id.* § 13(b).

98. *See id.* § 14(a).

99. *See id.* § 14(b). “[C]ash proceeds are identifiable if they are maintained in a segregated deposit account or, if commingled with other funds, to the extent they can be identified by a method of tracing” *Id.* § 14(d).

100. *Id.* § 14(c).

101. *See id.* § 8(a).

102. *Id.* § 8(b) (emphasis added).

103. *See id.* § 8(a).

104. *See id.* § 8(c), (d).

105. *See id.* § 8(c)(3).

106. *See id.* § 8(c)(3), (4).

107. *See id.* § 8(c)(2).

108. *See Walker*, *supra* note 42, at 7.

109. *See* TARA § 8(d).

110. *See id.* § 8(e).

111. *Id.* § 10(1).

112. See *Prince v. Brown*, 856 P.2d 589, 590 (Okla. Civ. App. 1993); *Coleman v. Hoffman*, 64 P.3d 65, 69-70 (Wash. Ct. App. 2003); NELSON & WHITMAN, *supra* note 22, § 4.25

113. See *J.H. Streiker & Co. v. SeSide Co. (In re SeSide Co.)*, 152 B.R. 878, 883 (Bankr. E.D. Pa. 1993) (classifying a lender's service of demand notices on tenants as taking constructive possession); *United Nat'l Bank v. Parish*, 750 A.2d 238, 239-40 (N.J. Super. Ct. Ch. Div. 1999) (treating a lender who collected rents pursuant to an assignment of rents as a mortgagee in possession).

114. See TARA § 10(1).

115. See *id.* § 10(2), (3), (4), (5), (6).

116. *Id.* § 12(a).

117. See *Freyermuth*, *supra* note 6, at 55-56.

118. See TARA § 12(b).

119. *Id.* §11.

120. *Id.* §15.

TEXAS ASSIGNMENT OF RENTS ACT

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TEXAS ASSIGNMENT OF RENTS ACT

SECTION 1. SHORT TITLE. This Chapter may be cited as the Assignment of Rents Act.

SECTION 2. DEFINITIONS. In this Chapter:

- (1) "Assignee" means a person entitled to enforce a security instrument.
- (2) "Assignment of rents" means a transfer of an interest in rents in connection with an obligation secured by real property from which the rents arise. An assignment of rents does not include charges permitted under Section 306.101 of the Finance Code or a true sale of rents.
- (3) "Assignor" means a person that makes an assignment of rents or, if the real property has been conveyed, the successor owner of the real property from which the rents arise.
- (4) "Cash proceeds" means proceeds that are money, checks, deposit accounts, or the like.
- (5) "Day" means calendar day.
- (6) "Deposit account" means a demand, time, savings, passbook, escrow or similar account maintained with a bank, savings bank, savings and loan association, credit union, or trust company or other person.
- (7) "Document" means information that is inscribed on a tangible medium or that is stored on an electronic or other medium and is retrievable in perceivable form.
- (8) "Notification" means a signed document containing information that this Chapter requires or permits a person to give to another.
- (9) "Person" has the meaning contained in the Code Construction Act, Gov. Code Sec. 311.005(2).
- (10) "Proceeds" means personal property that is received, collected or distributed on account of an obligation to pay rents.
- (11) "Rents" means:
 - (A) consideration payable for the right to possess or occupy, or for the actual possession or occupation of, real property;
 - (B) consideration payable to an assignor under a policy of rental interruption insurance covering real property;
 - (C) claims arising out of a default in the payment of consideration payable for the right to possess or occupy real property;
 - (D) consideration payable to terminate an agreement to possess or occupy real property;
 - (E) consideration payable to an assignor for payment or reimbursement of expenses incurred in owning, operating and maintaining, or constructing or installing improvements on, real property; or
 - (F) any other consideration payable under an agreement relating to the real property that constitutes rents under law of this state other than this Chapter.
- (12) "Secured obligation" means an obligation secured by an assignment of rents.
- (13) "Security instrument" means:
 - (A) a security instrument as defined in Sec. 51.001(6), Prop. Code; or
 - (B) an agreement containing an assignment of rents.
- (14) "Security interest" means an interest in property that arises by agreement and secures an obligation.
- (15) "Sign" means:
 - (A) signed as defined in Code Construction Act, Gov. Code Sec. 311.005(6); or
 - (B) an electronic signature as defined in Sec. 43.002(8), Bus. & Com. Code or Sec. 15.002(4), Prop. Code.
- (16) "Tenant" means a person that has an obligation to pay for the right to possess or occupy, or for possessing or occupying, real property.

SECTION 3. MANNER OF GIVING NOTIFICATION.

- (a) A person gives a notification or a copy of a notification under this Chapter:
 - (1) by transmitting it in accordance with Ch. 51, Prop. Code;

(2) by depositing it with the United States Postal Service or with a commercially reasonable delivery service, properly addressed to the intended recipient's address as specified in subsection (b), with first-class postage or cost of delivery provided for; or

(3) by transmitting it by any means agreed to by the person receiving it.

(b) The following rules determine the address for notification under subsection (a):

(1) the address for notification to an assignee is the address of the assignee provided in the security instrument or other document between the parties for this purpose, unless a more recent address for notices has been given by the assignee to the person giving the notification in accordance with Section 3(a) or as provided in a security instrument or other document signed by the assignee.

(2) the address for notification to an assignor is the address of the assignor provided in the security instrument or other document between the parties for this purpose or as provided in Chap. 51, Prop. Code, unless a more recent address for notices has been given by the assignor to the person giving the notification in accordance with Section 3(a) or as provided in a security instrument or other document signed by the assignor.

(3) the address for notification to a tenant is:

(A) if there is an address for notice in a signed document between the tenant and the person giving the notification, the person giving the notification shall use that address unless a more recent address for notice has been given by the tenant pursuant to that document;

(B) if there is not an address for notice in a signed document between the tenant and the person giving the notification, but the tenant's agreement with the assignor has an address for notices to the tenant and the person giving notification has received a copy of that document or has actual knowledge of the address for notices specified in that document, the person giving the notification shall use that address; or

(C) if neither (A) or (B) apply, the person giving the notification shall use the tenant's address at the real property covered by the security instrument.

(c) Notification given in accordance with this Chapter is deemed received upon the earliest to occur of:

(1) actual receipt by the person to whom notification is being given;

(2) five days after notification is given in accordance with Section 3(a)(2); or

(3) the time agreed to by the person receiving it.

SECTION 4. SECURITY INSTRUMENT CREATES ASSIGNMENT OF RENTS; ASSIGNMENT OF RENTS CREATES SECURITY INTEREST.

(a) An enforceable security instrument creates an assignment of rents arising from the real property described in the security instrument, unless the security instrument provides otherwise or the security instrument is governed by Section 50(a) (6), (7), or (8), Article XVI, Texas Constitution.

(b) An assignment of rents creates a presently effective security interest in all accrued and unaccrued rents arising from the real property described in the document creating the assignment, regardless of whether the document is in the form of an absolute assignment, an absolute assignment conditioned upon default or other event, an assignment as additional security, or any other form. The security interest in rents is separate and distinct from any security interest held by the assignee in the real property from which the rents arise.

(c) An assignment of rents does not reduce the secured obligation except to the extent the assignee collects rents and applies, or is obligated to apply, the collected rents to payment of the secured obligation.

Texas Comment: Subsection (c) of Section 4 is intended to eliminate confusion created by language in *Taylor v. Brennan*, 621 S.W.2d 529 (Tex. 1981), to the effect that an absolute assignment of rents is a pro tanto payment of the obligation. This section makes clear that unless the parties otherwise agree (a very unlikely agreement), the secured obligation is reduced only if and to the extent that the assignee collects rents and applies them. Simply taking an assignment of rents does not reduce the secured obligation.

SECTION 5. RECORDATION; PERFECTION OF SECURITY INTEREST IN RENTS; PRIORITY OF CONFLICTING INTERESTS IN RENTS.

- (a) A document creating an assignment of rents may be recorded in the county in which a part of the real property is located in the manner provided in Sec. 11.001, Prop. Code.
- (b) Upon recording, the security interest in rents is perfected, even if a provision of the document creating the assignment of rents or law of this state other than this Chapter prohibits or defers enforcement of the security interest until the occurrence of a subsequent event, including a subsequent default of the assignor, the assignee's obtaining possession of the real property, or the appointment of a receiver.
- (c) Except as otherwise provided in subsection (d), a perfected security interest in rents has priority over the rights of a person that, after the security interest is perfected:
- (1) acquires a lien or security interest against the rents or the real property from which the rents arise; or
 - (2) acquires an interest in the rents or the real property from which the rents arise.
- (d) An assignee of a perfected security interest in rents has the same priority over the rights of a person described in subsection (c) with respect to future advances as the assignee has with respect to its security interest in the real property from which the rents arise.

SECTION 6. ENFORCEMENT OF SECURITY INTEREST IN RENTS.

- (a) An assignee may enforce an assignment of rents using one or more of the methods specified in Sections 7 or 8 or any other method sufficient to enforce the assignment under law of this State other than this Chapter.
- (b) From the date of enforcement, the assignee is entitled to collect all rents that:
- (1) have accrued but remain unpaid on that date; and
 - (2) accrue on or after that date.

SECTION 7. ENFORCEMENT BY NOTIFICATION TO ASSIGNOR.

- (a) After default, or as otherwise agreed by the assignor, the assignee may give the assignor a notification demanding that the assignor pay over the proceeds of any rents that the assignee is entitled to collect under Section 6.
- (b) The date of enforcement against an assignor is the date on which an assignee gives a notification to the assignor under Section 3.
- (c) An assignee may not enforce an assignment of rents under this section if the real property constituted the assignor's homestead on which was located a one-to-four family dwelling on the date of the security instrument was signed and remains the assignor's homestead on the date of enforcement.

SECTION 8. ENFORCEMENT BY NOTIFICATION TO TENANT.

- (a) After default, or as otherwise agreed by the assignor, the assignee may give to a tenant of the real property a notification demanding that the tenant pay to the assignee all unpaid accrued rents and all unaccrued rents as they accrue. The assignee shall give a copy of the notification to the assignor. The notification must substantially comply with the form contained in Section 9 and be signed by the assignee or assignee's authorized agent or representative.
- (b) The date of enforcement against a tenant is the date on which the tenant receives a notification complying with subsection (a).
- (c) Subject to subsection (d) and any other claim or defense that a tenant has under law of this state other than this Chapter, after receipt of a notification under subsection (a):
- (1) a tenant is obligated to pay to the assignee all unpaid accrued rents and all unaccrued rents as they accrue, unless the tenant has previously received a notification from another assignee of rents given by that assignee in accordance with this section and the other assignee has not canceled that notification;
 - (2) except as otherwise agreed in a document signed by tenant, tenant is not obligated to pay rent to assignee that was prepaid to the assignor prior to receipt of a notification under subsection (a);

(3) unless the tenant occupies the premises as the tenant's primary residence, a tenant that pays rents to the assignor is not discharged from the obligation to pay rents to the assignee;

(4) a tenant's payment to the assignee of rents then due satisfies the tenant's obligation under the tenant's agreement with the assignor to the extent of the payment made; and

(5) a tenant's obligation to pay rents to the assignee continues until the tenant receives a court order directing the tenant to pay the rents in a different manner, a signed notification that a prior perfected security instrument has been foreclosed, or a signed document from the assignee canceling its notification, whichever occurs first.

(d) Except as otherwise agreed in a document signed by tenant, a tenant that has received a notification under subsection (a) is not in default for nonpayment of rents accruing within 30 days after the date the notification is received before the earlier of:

(1) 10 days after the date the next regularly scheduled rental payment would be due; or

(2) 30 days after the date the tenant receives the notification.

(e) Upon receiving a notification from another creditor that has priority under Section 5(c) that the creditor with priority has conducted a foreclosure of the real property from which the rents arise or is enforcing its interest in rents by notification to tenant, an assignee that has given a notification to a tenant under subsection (a) shall immediately give another notification to the tenant canceling the earlier notification.

SECTION 9. FORM OF NOTIFICATION TO TENANT.

The following form of notification, when properly completed, satisfies the requirements of Section 8:

NOTIFICATION TO PAY RENTS TO PERSON OTHER THAN LANDLORD

Tenant: [Name of Tenant]

Property Occupied by Tenant (the "Premises"): [Address]

Landlord: [Name of landlord]

Assignee: [Name of assignee]

Address of Assignee and Telephone Number of Contact Person: [Address of assignee]

[Telephone number of person to contact]

1. Assignee is entitled to collect rents on the Premises under **<Name of Document >** (the "Assignment of Rents") dated _____, and recorded at **<Recording Data>** of the _____ Records of _____ County, Texas. You may obtain additional information about the Assignment of Rents and Assignee's right to enforce it at Address of assignee.

2. A default exists under the Assignment of Rents or related documents between Landlord and Assignee. Assignee is entitled to collect rents from the Premises.

3. This notification affects your rights and obligations under the agreement under which you occupy the Premises (your "Lease Agreement"). Unless you have otherwise agreed in a document signed by you, if your next scheduled rental payment is due within 30 days after you receive this notification, you will not be in default under your Lease Agreement for nonpayment of that rental payment until 10 days after the due date of that payment or 30 days following the date you receive this notification, whichever occurs first.

4. You may consult a lawyer at your expense concerning your rights and obligations under your Lease Agreement and the effect of this notification.
5. You must pay to Assignee at the Address of Assignee all rents under your Lease Agreement which are due and payable on the date you receive this notification and all rents accruing under your Lease Agreement after you receive this notification.
6. If you pay rents to Assignee after receiving this notification, the payment will satisfy your rental obligation to the extent of that payment.
7. If you pay any rents to Landlord after receiving this notification, your payment to the Landlord will not discharge your rental obligation, and Assignee may hold you liable for that rental obligation notwithstanding your payment to Landlord, unless you occupy the Premises as your primary residence.
8. If you have previously received a notification from another person that also holds an assignment of the rents due under your Lease Agreement, you should continue paying your rents to the person that sent that notification until that person cancels that notification. Once that notification is canceled, you must begin paying rents to Assignee in accordance with this notification.

Name of assignee

By: Officer/authorized agent of assignee

SECTION 10. EFFECT OF ENFORCEMENT.

The enforcement of an assignment of rents by a method identified in Section 7 or 8, the application of proceeds by the assignee under Section 12 after enforcement, the payment of expenses under Section 11, or an action under Section 13 does not:

- (1) make the assignee a mortgagee in possession of the real property from which the rents arise;
- (2) make the assignee an agent of the assignor;
- (3) constitute an election of remedies that precludes a later action to enforce the secured obligation;
- (4) make the secured obligation unenforceable;
- (5) limit any right available to the assignee with respect to the secured obligation; or
- (7) bar a deficiency judgment pursuant to any law of this state governing or relating to deficiency judgments following the enforcement of any encumbrance, lien, or security interest.

SECTION 11. APPLICATION OF PROCEEDS.

Unless otherwise agreed, an assignee that collects rents under this Chapter or collects upon a judgment in an action under Section 13(c) shall apply the sums collected in the following order to:

- (1) the assignee's expenses of enforcing its assignment of rents, including, to the extent provided for by agreement and not prohibited by law of this state other than this Chapter, reasonable attorney's fees and costs incurred by the assignee;
- (2) reimbursement of any expenses incurred by the assignee to protect or maintain the real property subject to the assignment of rents;
- (3) payment of the secured obligation;

- (4) payment of any obligation secured by a subordinate security interest or other lien on the rents if, before distribution of the proceeds, the assignee receives a signed notification from the holder of the interest or lien demanding payment of the proceeds; and
- (5) the assignor.

SECTION 12. APPLICATION OF PROCEEDS TO EXPENSES OF PROTECTING REAL PROPERTY; CLAIMS AND DEFENSES OF TENANT.

- (a) Unless otherwise agreed by the assignee, an assignee that collects rents following enforcement under Section 7 or 8 is not obligated to apply the collected rents to the payment of expenses of protecting or maintaining the real property subject to an assignment of rents.
- (b) Unless otherwise agreed by a tenant, the right of the assignee to collect rents from the tenant is subject to the terms of any agreement between the assignor and tenant, or any claim or defense arising from the assignor's nonperformance of that agreement.

Texas Comment: Sections 10 and 12 of this Chapter are not intended to modify the law applicable to enforcement of an assignment by a method other than those specified in Sections 7 and 8 of this Chapter.

SECTION 13. TURNOVER OF RENTS; LIABILITY OF ASSIGNOR.

- (a) If an assignor collects rents that the assignee is entitled to collect under this Chapter, the assignor shall turn over the proceeds to the assignee within thirty days after notification from assignee under Section 7, or such other period as may be provided in a security instrument or other document signed by assignor and approved by assignee, less any amount representing payment of expenses authorized by a security instrument or other document signed by the assignee.
- (b) In addition to any other remedy available to the assignee under law of this state other than this Chapter, if an assignor fails to turn over proceeds to the assignee as required by subsection (a), the assignee may recover from the assignor in a civil action:
- (1) the proceeds, or an amount equal to the proceeds, that the assignor was obligated to turn over under subsection (a); and
 - (2) reasonable attorney's fees and costs incurred by the assignee to the extent provided for by agreement and not prohibited by law of this state other than this Chapter.
- (c) The assignee may maintain an action under subsection (b) either with or without taking action to foreclose any security interest that it may have in the real property.
- (d) Unless otherwise agreed, if an assignee that has priority under Section 5 enforces its interest in rents after another creditor holding a subordinate security interest in rents has enforced its interest under Section 7 or 8, the creditor holding the subordinate security interest in rents is not obligated to turn over any proceeds that it collects before it receives a signed notification from the assignee with priority that the assignee with priority is enforcing its interest in rents. The subordinate creditor shall turn over to an assignee with priority any proceeds that the subordinate creditor collects after it receives the notification from the assignee with priority that the assignee with priority is enforcing its interest in rents on or before thirty days after it receives the notification, or as otherwise agreed between the assignee with priority and the subordinate creditor. Any proceeds subsequently collected by the subordinate creditor shall be turned over to the assignee with priority on or before ten days after the proceeds are collected, or as otherwise agreed between the assignee with priority and the subordinate creditor.

SECTION 14. ATTACHMENT, PERFECTION AND PRIORITY OF ASSIGNEE'S SECURITY INTEREST IN PROCEEDS.

- (a) An assignee's security interest in rents attaches to identifiable proceeds.
- (b) If an assignee's security interest in rents is perfected, its security interest in identifiable cash proceeds is perfected.

- (c) Except as provided in subsection (b), Business and Commerce Code Chapter 9, or the comparable provisions of the Uniform Commercial Code of another applicable jurisdiction, determines (i) whether an assignee's security interest in proceeds is perfected, (ii) the effect of perfection or non-perfection, (iii) the priority of an interest in proceeds, and (iv) the law governing perfection, the effect of perfection or non-perfection, and the priority of an interest in proceeds.
- (d) For purposes of this Chapter, cash proceeds are identifiable if they are maintained in a segregated deposit account or, if commingled with other funds, to the extent they can be identified by a method of tracing, including application of equitable principles, that is permitted under law of this state other than this Chapter with respect to commingled funds.

SECTION 15. PRIORITY SUBJECT TO SUBORDINATION.

This Chapter does not preclude subordination by agreement by a person entitled to priority.

SECTION 16. APPLICATION TO EXISTING RELATIONSHIPS.

- (a) Except as otherwise provided in this section, this Chapter governs the enforcement of an assignment of rents, the perfection and priority of a security interest in rents, and the attachment and perfection of a security interest in proceeds even if the document creating the assignment of rents was signed and delivered before the effective date of this Chapter.
- (b) This Chapter does not affect an action, case or proceeding commenced before the effective date of this Chapter.
- (c) Section 4(a) of this Chapter does not apply to any security instrument signed and delivered before the effective date of this Chapter.
- (d) This Chapter does not affect:
- (1) the enforceability of an assignee's security interest in rents or proceeds if, immediately before the effective date of this Chapter, that security interest was enforceable;
 - (2) the perfection of an assignee's security interest in rents or proceeds if, immediately before the effective date of this Chapter, that security interest was perfected; or
 - (3) the priority of an assignee's security interest in rents or proceeds with respect to the interest of another person if, immediately before the effective date of this Chapter, the interest of the other person was enforceable and perfected, and that priority was established.

SECTION 17. EFFECTIVE DATE.

This Act takes effect immediately if it receives a vote of two-thirds of all the members elected to each house, as provided by Section 39, Article III, Texas Constitution. If this Act does not receive the vote necessary for immediate effect, this Act takes effect [September 1, 2011] [(stated date), 2011] [on the 91st day after the last day of the legislative session].

SECTION 18. CONFORMING AMENDMENTS.

- (a) Business and Commerce Code Section 9.109(d) (11) is amended to read:

"(11) the creation or transfer of an interest or lien on real property, including a lease or rents (as defined in Texas Property Code Section ----) thereunder, the interest of a vendor or vendee in a contract for deed to purchase an interest in real property, or the interest of an optionor or optionee in an option to purchase an interest in real property, except to the extent that provision is made for:

- (A) liens on real property in Sections 9.203 and 9.308;
- (B) fixtures in Section 9.334;
- (C) fixture filings in Sections 9.501, 9.502, 9.512, 9.516, and 9.519; and
- (D) security agreements covering personal and real property in Section 9.604;"