

## **BILL ANALYSIS**

Senate Research Center

S.B. 889  
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Enrolled

### **AUTHOR'S / SPONSOR'S STATEMENT OF INTENT**

S.B. 889 clarifies the process for a lender to perfect a lien on rent payments generated from the property that is the subject of the lien.

A lien against collateral is perfected when a person's security interest in that collateral is established with respect to third party creditors. With most types of security interests, perfecting a lien is a standardized process that is clearly defined in statute. This is very important from an economic standpoint because clarity provides lenders confidence that a loan is secured in the event of a default by a borrower.

It is standard practice that in a commercial lease transaction a lender will obtain a security interest in both the property being purchased and the rents and other proceeds that the property may generate. Such an interest is known as a collateral assignment of rents and provides a lender only a security interest in those proceeds.

A 1981 Texas Supreme Court case complicated this process by holding that a lender does not have a perfected security interest in a property's proceeds until the lender takes some proactive action to collect those proceeds directly from the property tenant following a default by the borrower. The result of this holding is that a lender's security interest may become subordinate to another party's security interest if that other party is able to perfect its lien before the lender perfects its security interest.

To resolve this issue, lenders have for decades required parties to a commercial real estate loan to execute an absolute assignment of rents, which states that a lender owns all proceeds from the subject property and will allow the property owner to use those rents until a default occurs.

The use of absolute assignment of rents agreements has, however, caused a separate problem for lenders. In some bankruptcy cases, it has been argued that rents collected and kept by the property owner should be credited against the owner's debt to the lender, even if the lender did not actually receive those funds. This argument is made based on the fact that the lender owns all proceeds paid on the property, regardless of whether any of those funds are actually applied against the debt.

Currently, there is no Texas statute addressing the perfection of a lien on rents.

The Uniform Assignment of Rents Act was developed by the National Conference of Commissioners on Uniform State Laws, beginning in 2003. S.B. 889, known as the Texas Assignment of Rents Act, or TARA, is a version of the national model legislation adapted to conform to Texas law.

This bill clarifies the process for perfecting a lien on proceeds from property and exempts residential estates so as not to put an unnecessary burden on home owners and residential tenants. More specifically, this bill states that if a deed of trust against real property is filed in a county's deed records, a lien against the proceeds from real property would automatically be perfected. Therefore, a lender could be confident that it holds a perfected lien on both a property and its proceeds at the time of filing. This bill eliminates the need for an assignment of rents agreement.

S.B. 889 amends current law relating to assignment of rents holders of certain security interests in real property.

### **RULEMAKING AUTHORITY**

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

### **SECTION BY SECTION ANALYSIS**

SECTION 1. Amends Section 9.109(d), Business & Commerce Code, to provide that this chapter does not apply to certain items, including the creation or transfer of an interest in or lien on real property, including a lease or rents, as defined by Section 64.001, Property Code, rather than the creation of transfer of an interest in or lien on real property, including a lease or rents 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 liens, fixtures, and security agreements.

SECTION 2. Amends Subtitle B, Title 5, Property Code, by adding Chapter 64, as follows:

#### CHAPTER 64. ASSIGNMENT OF RENTS TO LIENHOLDER

##### SUBCHAPTER A. GENERAL PROVISIONS

Sec. 64.001. DEFINITIONS. Defines, in this chapter, "assignee," "assignment of rents," "assignor," "cash proceeds," "day," "deposit account," "document," "proceeds," "rents," "secured obligation," "security instrument," "security interest," "sign," and "tenant."

Sec. 64.002. MANNER OF PROVIDING NOTICE. (a) Authorizes a person to provide a notice under this chapter:

(1) by transmitting the notice in the manner described by Section 51.002(e) (relating to service of notice);

(2) by depositing the notice with the United States Postal Service or a commercially reasonable delivery service, properly addressed to the intended recipient's address in accordance with this section, with first class postage or other cost of delivery paid; or

(3) by transmitting the notice to the intended recipient by any means agreed to by the intended recipient.

(b) Requires that notice to an assignee, except as agreed under Subsection (a)(3), be sent to the assignee's address as provided in the relevant security instrument or another document entered into for the purposes of this section by the assignee and the person sending the notice, unless a more recent address for notice has been given in a manner provided by Subsection (a) by the assignee to the person sending the notice or in a security instrument or other document signed by the assignee.

(c) Requires that notice to an assignor, except as agreed under Subsection (a)(3), be sent to the assignor's address as provided in the relevant security instrument or another document entered into for the purposes of this section by the assignor and the person sending the notice or an address for the assignor to which a notice of default under Section 51.002 (Sale of Real Property Under Contract Lien) is properly sent, unless a more recent address for notice has been given in a manner provided by Subsection (a) by the assignor to the person sending the notice or in a security instrument or other document signed by the assignor.

(d) Requires that notice to a tenant, except as agreed under Subsection (a)(3), be sent to:

(1) an address for notice to the tenant provided in a signed document entered into by the tenant and the person providing the notice, unless a more recent address for notice has been given by the tenant in accordance with that document;

(2) if an address for notice described by Subdivision (1) does not exist, the address provided in a written agreement between the tenant and the assignor for notices to the tenant if the person sending the notice has received a copy of that agreement or has actual knowledge of the address for notice specified in that agreement; or

(3) if an address for notice described by Subdivision (1) or (2) does not exist, the tenant's address at the real property covered by the security instrument.

(e) Provides that notice provided in accordance with this section is considered received on the earliest of:

(1) the date the notice is received by the person to whom the notice is provided;

(2) the fifth day after the date the notice is provided in accordance with Subsection(a)(2); or

(3) the date on which notice is considered provided in accordance with an agreement made by the person to whom the notice is provided for the purposes of this section.

[Reserves Sections 64.003-64.050 for expansion.]

#### SUBCHAPTER B. ASSIGNMENT OF RENTS

Sec. 64.051. SECURITY INSTRUMENT CREATES ASSIGNMENT OF RENTS; ASSIGNMENT OF RENTS CREATES SECURITY INTEREST. (a) Provides that an enforceable security instrument creates an assignment of rents arising from real property securing an obligation under the security instrument, unless the security instrument provides otherwise or the security instrument is governed by Section 50(a)(6) (relating to an extension of credit), (7) (relating to a reverse mortgage), or (8) (relating to the conversion and refinance of a personal property lien), Article XVI (General Provisions), Texas Constitution.

(b) Provides that 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 on default or another event, an assignment as additional security, or any other form. Provides that 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) Provides that 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.

Sec. 64.052. RECORDATION AND PERFECTION OF SECURITY INTEREST IN RENTS; PRIORITY OF INTERESTS IN RENTS. (a) Authorizes a document creating

an assignment of rents to be recorded in the county in which any part of the real property is located.

(b) Provides that, on recordation of a document creating an assignment of rents, the security interest in the rents is perfected. Provides that this subsection prevails over a conflicting provision in the document creating the assignment of rents or a law of this state other than this chapter that prohibits or defers enforcement of the security interest until the occurrence of a subsequent event, such as a subsequent default of the assignor, the assignee's obtaining possession of the real property, or the appointment of a receiver.

(c) Provides that, except as provided by Subsection (d), a perfected security interest in rents has priority over the rights of a person who, after the security interest is perfected, acquires:

(1) a lien on or other security interest in the rents or the real property from which the rents arise; or

(2) an interest in the rents or the real property from which the rents arise.

(d) Provides that an assignee of a perfected security interest in rents has the same priority over the rights of a person described by Subsection (c) with respect to future advances as the assignee has with respect to the assignee's security interest in the real property from which the rents arise.

**Sec. 64.053. ENFORCEMENT OF SECURITY INTEREST IN RENTS GENERALLY.**

(a) Authorizes an assignee to enforce an assignment of rents using one or more of the methods provided by Section 64.054 or 64.055 or another method sufficient to enforce the assignment under a law of this state other than this chapter.

(b) Entitles the assignee, on and after the date on which an assignee begins to enforce an assignment of rents, to collect all rents that:

(1) accrued before but remain unpaid on that date; and

(2) accrue on or after that date.

**Sec. 64.054. ENFORCEMENT BY NOTICE TO ASSIGNOR.** (a) Authorizes the assignee, after default, or as otherwise agreed by the assignor, to provide the assignor a notice demanding that the assignor pay the assignee the proceeds of any rents that the assignee is entitled to collect under Section 64.053.

(b) Provides that, for the purposes of Section 64.053, the assignee begins enforcement under this section on the date on which the assignee provides notice to the assignor in accordance with Section 64.002.

(c) Prohibits an assignee from enforcing an assignment of rents under this section if, on the date the security instrument was signed and the date of prospective enforcement, the real property constitutes the assignor's homestead on which is located a one-family to four-family dwelling.

**Sec. 64.055. ENFORCEMENT BY NOTICE TO TENANT.** (a) Authorizes the assignee, after default, or as otherwise agreed by the assignor, to provide to a tenant of real property that is subject to an assignment of rents a notice demanding that the tenant pay to the assignee all unpaid accrued rents and all unaccrued rents as they accrue. Requires the assignee to provide a copy of the notice to the assignor in the manner provided by Section 64.002. Requires that the notice substantially comply with the form prescribed by Section 64.056 and be signed by the assignee or the assignee's authorized agent or representative.

(b) Provides that, for the purposes of Section 64.053(b), the assignee begins enforcement under this section on the date on which the tenant receives a notice complying with Subsection (a).

(c) Provides that, subject to Subsection (d) and any other claim or defense that a tenant has under a law of this state other than this chapter, after a tenant receives a notice under Subsection (a):

(1) the 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 notice under this section from another assignee of rents provided by that assignee in accordance with this section and the other assignee has not canceled that notice;

(2) except as otherwise provided by a document signed by the tenant, the tenant is not obligated to pay to an assignee rent that was prepaid to the assignor before the tenant received the notice under Subsection (a);

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

(4) the 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) the tenant's obligation to pay rents to the assignee continues until the earliest date on which the tenant receives:

(A) a court order directing the tenant to pay the rents in a different manner;

(B) a signed notice that a perfected security instrument that has priority over the assignee's security interest has been foreclosed; or

(C) a signed document from the assignee canceling the assignee's notice.

(d) Provides that, except as otherwise provided by a document signed by the tenant, a tenant who has received a notice under Subsection (a) is not in default for nonpayment of rents that accrue during the 30 days after the date the tenant receives the notice until the earlier of:

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

(2) the 30th day after the date the tenant receives the notice.

(e) Requires an assignee that has provided a notice to a tenant under Subsection (a), on receiving a notice from another creditor who has priority under Section 64.052(c) that the creditor with priority has conducted a foreclosure sale of the real property from which the rents arise or is enforcing the creditor's interest in rents by notice to the tenant, to immediately provide another notice to the tenant canceling the earlier notice.

Sec. 64.056. FORM OF NOTICE TO TENANT. Provides that, when properly completed, the following form of notice satisfies the requirements of Section 64.055(a). Sets forth the required language of the form of notice.

Sec. 64.057. EFFECT OF ENFORCEMENT. Provides that the enforcement of an assignment of rents by a method provided by Section 64.054 or 64.055, the application of proceeds by the assignee under Section 64.059 after enforcement, the payment of expenses under Section 64.058, or an action under Section 64.060 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
- (6) bar a deficiency judgment under any law of this state governing or relating to deficiency judgments following the enforcement of any encumbrance, lien, or security interest.

Sec. 64.058. APPLICATION OF PROCEEDS GENERALLY. Requires an assignee who collects rents under this chapter or collects on a judgment in an action under Section 64.060, unless otherwise agreed by the assignor, to apply the sums collected in the following order to:

- (1) reimbursement of the assignee's expenses of enforcing the assignee's assignment of rents, including, to the extent provided for by agreement by the assignor and not prohibited by a 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 that is subject to the assignment of rents if the assignee elects or is required to apply the proceeds to those expenses under Section 64.059;
- (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 notice from the holder of the interest or lien demanding payment of the proceeds; and
- (5) payment of any excess proceeds to the assignor.

Sec. 64.059. APPLICATION OF PROCEEDS TO EXPENSES OF PROTECTING REAL PROPERTY; CLAIMS AND DEFENSES OF TENANT. (a) Provides that, unless otherwise agreed by the assignee, an assignee that collects rents following enforcement under Section 64.054 or 64.055 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) Provides that, 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 and any claim or defense of the tenant arising from the assignor's nonperformance of that agreement.

Sec. 64.060. TURNOVER OF RENTS; LIABILITY OF ASSIGNOR. (a) Requires an assignor, If the assignor collects rents that the assignee is entitled to collect under this chapter, to turn over the proceeds to the assignee not later than the 30th day after the date

the assignor receives notice from the assignee under Section 64.054 or within another period prescribed by a security instrument or other document signed by the assignor and approved by the assignee, less any amount representing payment of expenses authorized by a security instrument or other document signed by the assignee.

(b) Authorizes the assignee, in addition to any other remedy available to the assignee under a law of this state other than this chapter, if an assignor does not turn over proceeds to the assignee as required by Subsection (a), to 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 an agreement between the assignor and assignee and not prohibited by a law of this state other than this chapter.

(c) Authorizes the assignee to maintain an action under Subsection (b) with or without taking action to foreclose any security interest that the assignee has in the real property.

(d) Provides that, unless otherwise agreed by an assignee that has priority under Section 64.052, a subordinate creditor that has enforced the subordinate creditor's interest under Section 64.054 or 64.055 before the priority assignee enforces the priority assignee's interests in rents is not obligated to turn over any proceeds that the subordinate creditor collects before the subordinate creditor receives a signed notice from the priority assignee informing the subordinate creditor that the priority assignee is enforcing the priority assignee's interest in rents. Requires the subordinate creditor to turn over to a priority assignee any proceeds that the subordinate creditor collects after the subordinate creditor receives the notice from the priority assignee that the priority assignee is enforcing the priority assignee's interest in rents not later than the 30th day after the date the subordinate creditor receives the notice or as otherwise agreed between the priority assignee and the subordinate creditor. Requires that any proceeds subsequently collected by the subordinate creditor be turned over to the priority assignee not later than the 10th day after the date the proceeds are collected or as otherwise agreed between the priority assignee and the subordinate creditor.

Sec. 64.061. ATTACHMENT, PERFECTION, AND PRIORITY OF ASSIGNEE'S SECURITY INTEREST IN PROCEEDS. (a) Provides that an assignee's security interest in rents attaches to identifiable proceeds.

(b) Provides that, if an assignee's security interest in rents is perfected, the assignee's security interest in identifiable cash proceeds is perfected.

(c) Provides that, except as provided by Subsection (b), the provisions of Chapter 9 (Secured Transactions), Business & Commerce Code, or the comparable Uniform Commercial Code provisions of another applicable jurisdiction, determine:

(1) whether an assignee's security interest in proceeds is perfected;

(2) the effect of perfection or nonperfection;

(3) the priority of an interest in proceeds; and

(4) the law governing perfection, the effect of perfection or nonperfection, and the priority of an interest in proceeds.

(d) Provides that, 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 a law of this state other than this chapter with respect to commingled funds.

Sec. 64.062. PRIORITY SUBJECT TO SUBORDINATION. Provides that this chapter does not preclude subordination by agreement by a person entitled to priority.

SECTION 3. (a) Provides that, except as otherwise provided by this section, Chapter 64, Property Code, as added by this Act, 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 regardless of whether the document creating the assignment of rents was signed and delivered before the effective date of this Act.

(b) Provides that Chapter 64, Property Code, as added by this Act, does not affect an action or other proceeding commenced before the effective date of this Act.

(c) Makes application of Section 64.051(a), Property Code, as added by this Act, prospective.

(d) Provides that Chapter 64, Property Code, as added by this Act, does not affect:

(1) the enforceability of an assignee's security interest in rents or proceeds if, immediately before the effective date of this Act, 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 Act, 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 Act, the interest of the other person was enforceable and perfected and that priority was established.

SECTION 4. Effective date: upon passage or September 1, 2011.