Statement by R. Jeffrey Smith in favor of Senate Bill 597,
"An Act Adopting the Uniform Assignment of Rents Act"

To the Honorable Members of the Committee on Judiciary:

My name is R. Jeffrey Smith, and I am a partner with the law firm of Bingham McCutchen LLP, located in Hartford. For almost 30 years my practice has concentrated on the representation of lenders and developers for commercial real estate projects. I was appointed an unofficial member of the NCCUSL drafting committee for the Uniform Assignment of Rents Act.

As many of you know, commercial real estate is often financed on a so-called "non-recourse" basis, that is, in the event a borrower is unable to repay its loan, the lender agrees that it will look solely to the real estate collateral for repayment, without being able to pursue the borrower in the event the collateral is not worth the amount of its debt. In those situations, the lender underwrites the rental stream from the property, not the borrower's credit, to assure itself that it will be repaid. Obviously in such a situation, the lender's ability to gain control of its collateral, and in particular the rents, is paramount. However, our laws - many of which trace their origins back to medieval England, long before "non-recourse financing was ever thought of - make it very difficult for a lender to gain control of its collateral. Not only that, but these laws have led to a great deal of confusion among bankruptcy judges as to what the parties' respective rights are in the rents, because bankruptcy courts must look to state law to determine parties' property rights. There have been two profound real estate market collapses during my career, and it is accurate to characterize these periods as "free for alls" as lenders and borrowers fought over control of rents. Neither borrower nor lender could confidently predict how a bankruptcy court would treat the rents. In anticipation of bankruptcy, lenders and borrowers often gave conflicting instructions to tenants regarding their rent payments, with tenants left in the middle of this tug-of-war. Throughout the country, bankruptcy courts struggled to determine what the respective rights of lenders, borrowers and tenants were in these situations. In the absence of modern state law, many courts relied upon obscure and ancient legal theories to craft what they perceived to be the "right result" in a particular case, further detaching the law from modern commercial practice. Not surprisingly, the cases are inconsistent and often wildly contradictory, leaving us still in confusion.

In my opinion, the Act provides clear direction for the real estate community in this important area. At its heart, it ensures that the expectation of a lender and borrower at the inception of their deal, namely, that the lender can rely upon a property's rental income to be available to repay its loan, is protected. When more than lender may be involved, it establishes clear rules concerning their relative priorities in the rents. It removes tenants from the uncomfortable position of being caught in the middle of a battle between two parties jockeying to collect rents. In achieving this, the Act has avoided favoring any party - it does not alter contractual relationships, or increase economic burdens. Rather, by providing clear instructions on the rights of various parties to the rents of real property, it preserves and promotes the enforcement of the parties' original contractual expectations, while ensuring that tenants are not left twisting in the process.

Attached is a brief client alert memo prepared by my and one of my partners, Erica Weiss. This alert provides more details concerning the more important provisions of the Act.

Thank you for your consideration of this significant legislation.

Respectfully submitted,

R. Jeffrey Smith

ATTACHMENT TO
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The National Conference of Commissioners on Uniform State Laws recently approved the Uniform Assignment of Rents Act. The purpose of the Act is to codify a consistent approach to the creation, perfection, priority and enforcement of lenders' security interests in rents. Existing state law in this area is often vague, contradictory or non-existent. As a result, bankruptcy courts -- which look to state law to determine the nature of a lender's interest in rents pledged as collateral -- often go through tortured reasoning to reach what they perceive to be the right conclusion. Such judicial gymnastics have created uncertainty for lenders and caused widely varying practices from state to state by lenders seeking to preserve their right to collect the rents after a default by the borrower. Similarly, the laws of the various states concerning the right to appointment of a receiver, the right to require tenants by notification to pay rents directly to the lender and the impact of one-action rules vary widely. The Act seeks to promote uniformity in these and other important areas as well.

The highlights of the Act are as follows:

- a mortgage/deed of trust granting a lien on real property automatically creates an assignment of the rents arising from that property, unless the mortgage otherwise provides.

- an assignment of rents creates a security interest in all accrued and future rents arising from the real property, regardless of whether the assignment is styled as an absolute, collateral, conditional or other assignment.

- recordation of the assignment perfects a lender's security interest in the rents and makes it effective against third parties. The Act thereby rejects case law requiring that the lender take some additional step, such as notifying tenants, taking possession of the property or getting a receiver appointed, in order to "activate" the assignment.

- the term "rents" is broadly defined as all sums payable for the right to possess or occupy the real property of another, thus expanding the traditional definition of "rents" to include hotel room revenues, nursing home room occupancy charges and marina slip fees, among other revenue sources.

- rules are established for determining the priority of a perfected security interest in rents vis-à-vis other parties.

- the Act entitles a lender to the appointment of a receiver, to demand that the borrower turn over rents, and to direct tenants to pay rents directly to the lender, in order to enforce the assignment.

- the Act provides clear direction to tenants regarding their rights and obligations when faced with potentially conflicting direction from its landlord and lenders concerning its rental payments.