Using Assignments of Rents and Leases Effectively

By Stuart J. Glick

Your bank is in the process of foreclosing on a commercial property. Should it appoint a receiver, as most lenders do, or should it exercise its rights under an assignment of rents and leases?

An absolute and unconditional assignment of the rents and leases associated with mortgaged premises is a standard right provided to a lender in every commercial mortgage transaction. Generally, a lender obtains this right both in its mortgage and in a separately executed document. If more sophisticated tenants are involved, the lender and the tenants often enter into separate subordination and non-disturbance agreements: the tenant agrees to comply with the assignment of rents; and the lender agrees to leave the tenant’s leasehold undisturbed in the event of foreclosure.

In the process of foreclosing, your assignment of rents and leases rights may help maximize your recovery.

Jurisdictions differ in their interpretation and application of such assignments, however. Some treat them as nothing more than security interests; others recognize them as a present transfer of title to the rents. Lenders are not required to seek judicial intervention to enforce these rights (although they may not disturb the peace in doing so). In cases where judicial enforcement is sought, most courts strictly enforce these provisions.

In practice, though, most lenders are unwilling to exercise this remedy. Collecting a property’s revenues without paying its expenses is unsustainable. Accordingly, the common belief is that by exercising an assignment of rents, a lender must necessarily make business decisions regarding the payment of expenses to maintain the property’s viability.
Yet, no lender willingly chooses to become so involved in its borrower’s business, given the perils in doing so. Besides potential lender liability claims, assuming such control could result in a lender being deemed a mortgagee in possession, which has its own risks. Consequently, lenders, almost by rote, seek the appointment of a rent receiver following the commencement of a foreclosure.

Rent receiverships pose their own problems to lenders, however, and courts differ in their implementation of these provisions. Despite a mortgage provision mandating appointment of a receiver upon a default, some courts maintain that the appointment is an exercise of the court’s equitable powers that should not be wielded without additional lender proofs (for example, borrower mismanagement of the property, misappropriation of rents, under-collateralization, or other borrower malfeasance). In many jurisdictions, the lender has no control over selection of the receiver.

The right to foreclose, in and of itself, is an equitable remedy. When exercising its equitable powers, a court is seeking to be fair and just. While it will not rewrite a contract to give a party rights not found under it, it will typically not oppose a solution involving an exercise of less than a party’s full rights.

Given that the assignment of rents requires the payment of all rents to the lender, most courts will enforce less than the lender’s full panoply of rights. Thus, rather than requiring the mortgagor to pay all rents to the lender, a lender can consent to the mortgagor’s payment of net rents after the mortgagor pays its usual expenses incurred in the ordinary course of the mortgagor’s business, with extraordinary expenses subject to lender or court approval.

The net payment requirement should be combined with a monthly accounting obligation (with corroborating information if the lender so requests) and reasonable access to books and records (a typical mortgagee right). When the mortgagor is not suspected of wrongdoing or is already employing an independent management company, this remedy is particularly useful: A lender benefits the same as it would from having a receiver appointed, but without the attendant costs.

Last, a lender may combine the assignment of rents and leases remedy with the lender’s typical mortgage right to appoint a property’s manager. While this step is closer to a lender becoming a mortgagee in possession, the right manager may provide a sufficient “shield” to insulate the lender from borrower claims, particularly when the right is exercised by court order. The right manager can efficiently and economically provide the same benefits as a receiver, but without the potential complications and costs.

So the next time you are in the process of foreclosing, don’t simply ignore your assignment of rents and leases rights. They may just maximize your recovery.

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