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## Rents as Collateral in Utah

1. **The Problems with Rents as Collateral.** When a mortgage lender (i.e., mortgagee) takes a security interest in real estate by means of a trust deed or a mortgage (for present purposes, let's refer to either as a "mortgage"), it generally wants a lien against the land and buildings and also against the rents otherwise payable to the mortgage borrower (i.e., the mortgagor), by the tenants of the land or building. The typical mortgage will contain in the description of the property subject to the mortgage the legal description together with a statement that the mortgage also covers appurtenances and so on and covers "rents, issues, and profits" or similar terms. A typical mortgage will also contain a separate provision granting an assignment of rents. This sounds straight forward, but is not. There are serious issues that confuse the matter.

a. **No UCC.** The Uniform Commercial Code ("UCC") provides no help because it typically does not apply to the matter of assignments of rents; rather, such assignments are governed by real property law. See UCA § 70A-9a-109(3)(k).

b. **Traditional Doctrine.** Under traditional common law doctrine applicable in lien theory states (such as Utah), an assignment of rents is not effective until there has occurred both foreclosure of the mortgage and some additional action to enforce the assignment of rents (such as obtaining a court appointed receiver), and then only against rents arising after the enforcement action. In lien theory states, the borrower (mortgagor) owns the mortgaged property and its associated rents until foreclosure, and rents do not go to the lender (mortgagee) until it obtains possession of the property or until the rents are attached or sequestered. The effect has been justly criticized as confusing the creation of a lien with its enforcement. John C. Siemers, *The Mortgagee's Lien Against Rents*, 25 Tx. Tech. L. Rev. 873 (1994); Amanda L. Burcham, Comment, *Texas Should Adopt the Uniform Assignment of Rents Act: A Comprehensive Statute to Eliminate the Technical Constructions of State Mortgage Law and Secure Lender's Access to Pledged Rents*, 60 SMU L. Rev. 579 (Spring 2007). These criticisms also note the strangeness of the interpretations of state law that would allow an "absolute assignment" to be a lien prior to enforcement, but not a "collateral assignment," although both are granted to secure a loan. See Burcham, Comment, *op. cit.* Such doctrines will make life hard on creditors in state court.

c. **Bankruptcy Concerns.** The situation could, however, be different before a bankruptcy court. See, e.g., *SLC Ltd. V v. Bradford Group West (In re SLC Ltd.V)*, 152 B.R 755 (Bnkr. Ut. 1993) (Judge Boulden) (security in rents was perfected on trust deed recording, not at later appointment of a receiver). Noting the lack of seminal Utah law and noting that Utah is a lien theory state such as those applying the traditional common law doctrine, the court in the *SLC Ltd. V* case nevertheless found there is a significant difference between perfection and

enforcement. The concept of “perfection” has not always been as important in real estate law, but it is of great importance in bankruptcy law because unperfected interests are subject to attack in bankruptcy proceedings. See Bankruptcy Code (“BC”) § 544. In 1994 Congress passed the Bankruptcy Reform Act of 1994 to provide clarity to the issue by amending BC § 552(b) to provide that security interests in rents (including hotel, motel, and lodging charges) under a pre-petition security agreement apply to rents acquired by the bankruptcy estate post-petition to the extent provided in the security agreement, unless the court orders otherwise based on the equities of the case. There was no reference in this provision to “applicable non-bankruptcy law.” However, it has been argued that the strong arm provisions of BC § 544 would allow a bankruptcy trustee to avoid any lien that a judgment creditor or bona fide purchaser of the realty could have avoided under state law as of the petition date, because state law was not expressly preempted. R. Wilson Freyermath, *Modernizing Security in Rents: The New Uniform Assignment of Rents Act*, 71 Mo. L. Rev. 1 at 28 (2006). Under this argument, the strong arm provision, which is tied to other state law, recreates the problem.

d. Loan Documents Use of Cash. Another issue of a more practical nature facing a lender, is assuring that the rents are used by the borrower first to maintain and protect the property (i.e., that the borrower does not engage in “rent milking”). To solve this issue, covenants in loan documents and close monitoring by the lender are needed, but some lenders will want closer control of the cash proceeds from rents to assure their proper use, when such controls are economically justifiable.

2. A Solution for Rents as Collateral. In Utah, these issues have largely been resolved by its adoption, in 2009, of the Utah Uniform Assignment of Rents Act (the “Act”), UCA § 57-26-101 *et seq.* This Act is based on the Uniform Assignment of Rents Act adopted by the National Conference of Commissioners on Uniform State Laws (July, 2005). An assignment of rents will usually be associated with a mortgage. However, under the Act, it is a separate and distinct security interest and thus apparently need not always be associated with a mortgage but possibly could stand alone and be transferred separately, so long as it was granted in connection with an obligation secured by the real property from which the rents arise. See UCA § 57-26-102(2) (definition of “assignment of rents”) and UCA § 57-26-104(2) (separate and distinct). However, the obligation to pay rents is not bifurcated from the lease by the assignment of rents. Comment 2 to Section 2 of the Uniform Act. Most such assignments are generally termed “assignments of leases and rents;” this is the same thing as an assignment of rents under the Act. Nevertheless, a rent-stripping type of transaction does not appear to be prevented by the Act. Among the key features of this Act are:

a. No “Absolute” Distinction. There is no distinction between “absolute” and “collateral” assignments where a security interest is involved. UCA § 57-26-104(2). This eliminates a great deal of problematic contract interpretation.

b. Presumption of Assignment. An enforceable security instrument (a security instrument is any instrument that creates or provides a security interest in real property, whether or not personal property is included; UCA § 57-26-102(14)) automatically creates an assignment of the rents arising from the real property, unless the security instrument provides

otherwise. Installment land sales contracts for later deed delivery are security instruments subject to the presumption of an assignment of rents.

i. Residential Remedy Restrictions. However, with respect to any kind of security instrument, non-judicial enforcement by notification of the assignor (i.e., the borrower) or of the tenant under UCA §§ 57-26-108 or 109 is not allowed for implied assignments with respect to residential property while the assignor resides there as his or her primary residence. The Act apparently would apply this limit both to the situation where the borrower lived in the residence at the time the loan was made (and has not moved out) and where the borrower while not living there at the time the loan was made, later moves in. This limitation would, for example affect a loan on a residential property occupied by the borrower who rents out a room in the home. The mortgage would need to be explicit as to the assignment of rents for the lender to have the non-judicial remedies in this situation.

ii. Cram Down Effect. The presumed assignment (or an explicit grant of assignment, for that matter) should not cause the security for the obligation to be something other than real property. This is important under BC § 1322(b)(2) which in a Chapter 13 proceeding permits a debtor to modify the rights of a mortgagee (“cram down”) except where the claim is “secured only by a security interest in real property that is the debtor’s residence.” The assignment is still of rents which are still treated as a real property interest (an “incorporeal hereditament”) and thus under the case law “the grant of an interest in rents does not render the claim secured by anything other than real property.” *See In re Fernandos*, 402 F.3d 147 (3<sup>rd</sup> Cir. 2005). The residential mortgagee should still be protected from cram-down.

c. Perfection. The security interest in rents is perfected by recording in the real property records the instrument creating the assignment. UCA § 57-26-105(1) and (2). The perfected interest has priority, including with respect to future advances, over rights under any later arising judicial lien against the rents or the real property itself, and over rights arising from any later purchase (including by sale, lease, lien, security interest, gift, or other voluntary transaction; UCA § 57-26-102(11)) of an interest in rents or in the real property. UCA § 57-26-105(3) and (4). This solves the issue of whether the strong arm provision of BC § 544(a) might trump the reformed provision of BC § 552(b) – not in Utah.

d. Rents. The Act covers “rents,” which term is defined to include a number of items which have raised issues in the past. UCA § 57-26-102(12). The general definition is that rents are sums payable for the right to possess or occupy, or for the actual possession or occupation, of real property of another person, and include sums payable under an agreement relating to the real property of another that constitutes rents under other state law. The statute goes on to explicitly clarify that the term includes amounts payable under rental interruption insurance, claims arising from default in the payment of sums for the right to possess or occupy the real property, sums payable to terminate an agreement to possess or occupy the real property, and sums payable for expenses incurred in owning, operating, maintaining, and improving real property. Whether the relationship is a landlord-tenant relationship or only a license, if the terms of the definition are met, which definition focuses on the possession and occupation of real property, the sums payable are rents.

i. Examples of Rents. Under the Act, as explained by the official commentary to Section 2 of the Uniform Act, the term “rents” includes hotel room charges (but not room service or laundry services), base and percentage rents, holdover amounts after the rental term even if the tenant is now a trespasser, nursing home room fees (but not medication, therapy, or other services), marina slip fees, and reserved parking fees. Golf green fees are not rents, and stadium reserved seating ticket prices are an open issue.

ii. Goods or Services. It should be noted that the definition requires “sums” payable, thus excluding such things as crop rents or payments denominated other than in terms of money, such as goods or services. The related term “proceeds” of rents means personal property, of any kind, received or collected on account of a tenant’s obligation to pay rents. UCA § 57-26-102(10). Proceeds may but need not be cash proceeds which are checks, deposit accounts, and the like. UCA § 57-26-102(4). It may be that rents denominated in terms of a money obligation but accepted from the tenant by the assignor as some other form such as goods or services, would be proceeds of rents. If this is done regularly as part of the arrangement, the lender assignee may be well advised to perfect both under the Act and the UCC.

e. Enforcement Generally. Lenders may enforce the assignment of rents against accrued but unpaid rents and against all subsequently accruing rents from the date of enforcement, including before foreclosure. UCA § 57-26-106(2). The date of enforcement is thus a key date.

i. Assignee Lender Protection. Enforcement does not make the assignee lender a purchaser in possession of the real property or an agent of the assignor borrower. UCA § 57-26-111(1) and (2). These provisions help protect the enforcing lender from acquiring unexpected duties to third parties. Mortgagees in possession may, for example, acquire duties under tort law to third persons and a duty to maintain the property. There is no general duty under the Act for the assignee to use the rents to maintain or protect the real property. UCA § 57-26-113(1). Also, such enforcement of the assignment of rents does not violate Utah’s one action rule (the one action rule is at UCA § 78B-6-901), constitute an election of remedies, limit any rights of the assignee lender as to the secured obligation, limit the right of foreclosure or of sale under a power of sale (e.g., in a trust deed), or bar a deficiency judgment. UCA § 57-26-111(3) through (8). Thus, the lender’s other rights and remedies remain intact.

ii. Marshalling. The Comments, however, make clear that the Act does not limit a court’s equitable discretion to order marshalling of assets in appropriate cases, such as where the mortgagee assignee on property A also is secured on the same loan by property B in which another creditor is also secured. The court could order the mortgagee on property A to look to that property and the associated assignment of rents first. Comment 4 to Section 11 of Uniform Act.

f. Non-exclusive Methods of Enforcement. The Act provides for several methods of enforcement, but these methods are not exclusive. The various methods of enforcement may be used concurrently (subject, however, to the general authority of the court to prevent abuse). Any other allowable method under state law may be used as well. UCA § 57-26-106(1). The commentary to the Uniform Act Section 6 notes that a mortgagee could, where

otherwise allowable by law, choose to become a mortgagee in possession under state law (and take on the duties associated with that status), for example, in order to stop waste or the deterioration of the property as well as to collect rents. The lender could also sue the borrower to collect the rents without running afoul of the one action rule because “the security interest in rents is separate and distinct from any security interest held by the assignee in the real property” (UCA § 57-26-104(2)), enforcement of the assignment specifically does not violate the one action rule (UCA § 57-26-111(7)), and such a suit is specifically authorized under the Act even without foreclosure (UCA § 57-26-114(4) and (5)).

g. Enforcement by Notification. The Act provides for enforcement by notification of the assignor borrower to turn over rents and by notification of the tenants to pay rent directly to the assignee. Either or both can be used.

i. Notification of Assignor. Under UCA § 57-26-108 upon a default by the assignor borrower, the assignee lender can give notice to the assignor borrower to turn over all proceeds of rents. Also, a copy of the notice is to be provided to anyone else with a recorded assignment of rents as of 10 days before the notice; failure to do so does not affect the effectiveness of the notice to the assignor borrower, but the other holders of interests in the rents may be entitled to any relief allowable under other law. The date the assignor receives the notice is the date of enforcement.

ii. Notification of Tenants Generally. The notification of the assignor borrower will often occur at the same time as the assignee lender notifies tenants to pay rent directly to the assignee lender under UCA § 57-26-109. This notice to tenants can be given at default or at any time agreed by the assignor. Thus, the tenants may be required to pay rent directly to the lender under the loan documents even before default as part of a cash control arrangement. A copy of the tenant notice must be provided to others claiming an interest in rents with assignments of record 10 days before the notice; failure to give the notice to the other interest holders has no effect on the tenant, but the other holders may be entitled to remedies. The tenant notice needs to be signed by the assignee and contain certain specified information including the identities of the key parties and premises, recording data, a claim of right to collect the rents, instructions for direct payment, a description of the effect of direct payment, contact information for the assignee for payments or inquiries, and a statement that tenant may consult a lawyer. The statute has in it a form of notice at UCA § 57-26-110. The date of enforcement is the date the tenant receives the notice.

iii. Effect of Tenant Notification. The tenant notice has the effects under the Act that

1. the tenant is now obligated to pay accruing rent to the assignee lender (unless the tenant has earlier received a similar notice from another assignee),
2. if the tenant pays rent to the assignor borrower the tenant is not discharged of the obligation to pay the assignee lender

(unless the tenant occupies the premises as the tenant's primary residence),

3. payment to the assignee satisfies the obligation to the assignor to the extent of the payment, and
4. the tenant must continue to pay the assignee lender until the tenant receives a cancellation of the notice or a court order to pay in a different manner.

This process can provide a potent remedy for the lender, with a weakness, however, for residential rental properties where payment by the tenant to the assignor borrower discharges the tenant. Also, the tenant's obligation to pay rents remains subject to any claim or defense otherwise available to the tenant under other law. UCA § 57-26-109(3) and Comment 2 to Section 9 of the Uniform Act. This could, of course, affect the ability of the lender to collect rents where the borrower assignor has defaulted in its duties as a landlord, at least in the absence of a "hell or high water" clause effective against the tenant, making rents payable regardless of any otherwise applicable offsets or defenses of the tenant. UCA § 57-26-113(2) and UCA § 57-26-109(3).

iv. Tenant Grace. The tenant may well be confused by the notice. The statute thus provides some grace to the tenant. The tenant receiving such a notice is not in default for non-payment as to rents accruing within 30 days of receipt of the notice until the earlier of 10 days after the payment would otherwise be due or 30 days after receipt of the notice. For example, if rents are payable in advance monthly on the first day of month, say March 1, and the notice is received February 15, the rents accruing for February will have already been paid (assuming no tenant default) and the rents accruing for March will now be due March 11. As another example, if instead of accruing monthly, rents accrue quarterly in advance and the notice is received February 15, the payment for the quarter beginning in April 1 will be payable when normally due since that date is 30 days after the date the notice was received.

v. Tenant Notice Priority. In order to prevent a quicker notice from a subordinate holder of an interest in rents from trumping the priority of the holder with priority, when the subordinate holder receives notice from a holder with priority that it is enforcing and is continuing to enforce its interest, the subordinate holder must immediately notify the tenant that the subordinate holder's notice is cancelled. Thus payments will then begin going to the priority holder. However, the subordinate assignee need not turn over to the assignee with priority amounts earlier collected in good faith by the subordinate assignee while it had not yet received notice that the senior assignee has enforced its assignment. UCA § 57-26-114(6).

h. Receiver. Another method of enforcement allowed by the Act is to obtain appointment of a receiver. UCA § 57-26-107. This remedy applies even to owner occupied residences.

i. Right to Appointment on Default. A number of issues relating to the appointment of a receiver are eliminated by the Act because the Act states that an assignee lender is entitled to the appointment of a receiver when the assignor borrower is in default and

any of four conditions apply: (i) the assignor has signed an agreement providing for the appointment on default (some courts have not always honored such agreements), (ii) it appears likely the real property may not be sufficient to satisfy the obligation, (iii) the assignor failed to turn over to the assignee proceeds the assignee is entitled to collect, or (iv) a subordinate assignee of rents obtains the appointment of a receiver for the property.

ii. Appointment Under Other Law. Even without a default and the meeting of these conditions, an appointment of a receiver may still be obtained if justified under other law. See Ut. Rul. Civ. Proc. (“URCP”) 66 regarding appointment of receivers. One ground, among others, for appointment under URCP 66 is that “property is in danger of being lost, removed, damaged, or is insufficient to satisfy a judgment, order, or claim,” and another ground exists “in all other cases in which receivers have been appointed by courts of equity.” Waste, which may for some courts include failure to pay real property taxes, may provide grounds for appointment under this Rule.

iii. Procedural Matters. Whether or not any appointment may be granted ex parte would be determined under other applicable rules. See generally, e.g., URCP 65A. As under the enforcement by notice provisions, the petition for appointment of a receiver must be provided to other holders with recorded assignments 10 days before the date of the petition. The date of enforcement under this section is the date the court enters an order appointing a receiver for the real property subject to the assignment. Although the receiver for the assignee with higher priority has priority over another appointed but subordinate receiver, the subordinate receiver is protected in collecting and applying rents in accordance with the order of appointment. UCA § 57-26-107(6).

i. Assignee Duties. The assignee of rents which collects rents following enforcement by notice to the assignor borrower or to the tenant has no duty to apply the rents to pay expenses of protecting or maintaining the real property, unless the assignee has agreed to do so. UCA § 57-26-113(1). (A receiver appointed by the court would likely have a duty to protect the property under the court’s order.) Assuming the assignor lender has not agreed to so use the proceeds, the tenants may have defenses or offsets to the payment of rents, absent an agreement by the tenants, such as in a subordination, non-disturbance, and attornment agreement (an “SNDA”), not to assert against the lender any claims or defenses otherwise applicable against landlord (i.e., assignor). UCA § 57-26-109(3).

i. Tenants Receiver. Further the Act explicitly leaves open the possibility that tenants could under other law, obtain the appointment of a receiver of the property in order to protect their interests where the landlord (i.e., the borrower assignor) had obligations to take care of the property, pay taxes on it, or insure it. Mere non-payment by the assignee lender may not alone be sufficient to justify a receiver. Comment 3 to Section 13 of the Uniform Act.

ii. Application by Assignee. Of course, the assignee may want to pay such expenses in order to protect itself and its collateral, and to keep rent cash flowing. If the lender assignor does pay such expenses, it may apply the collected rents to such expenses without reducing the secured obligation. UCA § 57-26-112(2). Unless otherwise agreed, the rents collected by enforcement under the Act’s remedies or by a judgment (see UCA § 57-26-

114(4)) are generally applied by assignee first to reasonable enforcement expenses (including reasonable attorney's fees if provided in the agreement and not otherwise prohibited by law), second, to reimbursement of expenses to protect or maintain the property, third, to the secured obligation, fourth, to any subordinate security interest or any other lien on rents where the collecting assignee has received notification from the other creditor demanding payment, and then, fifth, to the assignor borrower.

j. Priority as to Proceeds. Where different secured parties claim an interest in the right to rents, the Act provides the priority as to collections based on the time of recording under the recording act, which recording perfects the interest in rents. Thus, as we have seen, the first recorded assignment has priority over later judicial liens on rents or on the real property from which they arise and over later acquired interests in the rents. UCA § 57-26-105. The Utah recording act is UCA § 57-3-101 *et seq.* However, where there are proceeds of rents, there could be conflicts with security interests governed by the Uniform Commercial Code's Article 9. Utah's version of UCC Article 9 is at UCA § 70A-9a-101 *et seq.* As used in the Act, a "conflicting interest" is an interest in proceeds held by someone else (i.e., other than the assignee) that is a security interest arising under Article 9 or is an interest the priority of which between the holder of the interest and the holder of an Article 9 security interest is resolved by Article 9. Where there is a conflicting interest as to the proceeds of rent, there are two different rules, one for cash proceeds and the other for non-cash proceeds.

i. Cash Proceeds. The assignee with a perfected (i.e., recorded) interest in rents also has a perfected interest in the identifiable cash proceeds of the rents. UCA § 57-26-115(2). Cash proceeds are money, checks, deposit accounts, and the like. UCA § 57-26-102(4). Deposit accounts are depository accounts of various types at banks, savings and loans, credit unions, and trust companies. See UCA § 57-26-102 (6), and compare to the UCC definitions of "bank" (UCA § 70A-1a-204) and of "cash proceeds" (UCA § 70A-9a-102(9)). "Identifiable" means, for purposes of the Act, proceeds in a segregated account, or which are co-mingled but traceable under other Utah law, including equitable principles. UCA § 57-6-114(3). Presumably tracing under the Act and under UCC Article 9 follow the same principles. See UCA § 70A-9a-315(2)(b). In the case of identifiable cash proceeds, the perfected interest of the assignee in the cash proceeds has priority over every other conflicting interest, except one where the other secured party has perfected by control. UCA § 57-26-115(4). Thus, a control agreement over a bank account into which rent proceeds are deposited, will provide priority to the secured party with the control agreement, trumping the priority of the perfected assignee of rents. The perfected interest of the assignee in cash proceeds can be trumped as well by a right of recoupment or set off (for example, of the depository bank) which right of recoupment or set off will have priority over it. See UCA § 57-26-115(5) and UCA § 70A-9a-340. To avoid these chances of such trumping, the assignee lender could itself have Article 9 control where the assignee lender, rather than the assignor borrower is the bank's customer. See the discussion at Illustration 5, below, concerning the effect of a Utah modification to the Uniform Act.

ii. Non-Cash Proceeds. The perfected assignee of rents loses its perfection if the rent proceeds become non-cash proceeds unless the assignor perfects as to the non-cash proceeds under Article 9, and Article 9 will provide the priority rules as to the interests in the non-cash proceeds of the rents. UCA § 57-26-115(2) and (3). An unperfected interest in

non-cash proceeds will lose out against a perfected interest under Article 9. A perfected interest of the assignee in non-cash proceeds will need further analysis under Article 9. Such a perfected interest could be obtained by perfection at the front end of the loan (e.g., by a grant of an interest and the filing of a UCC-1 Financial Statement covering essentially all the assets of the borrower) or, with some risk, as needed where rent proceeds are used by the borrower to buy something, such as equipment.

iii. Illustrations. Comment 4 of the Official Comments to the Uniform Act Section 15 provides these useful illustrations:

*Illustration 1.* In year 1, Debtor grants to Secured Party an effective security interest in all of Debtor's existing and after-acquired assets, and Secured Party perfects this security interest by filing. In year 2, Debtor makes an assignment of rents to Assignee, and Assignee promptly records. In year 3, Debtor receives a rent check from Tenant. Assignee has a perfected security interest in the check as identifiable cash proceeds of rents. Secured Party has a perfected security interest in the check, but Secured Party's security interest is perfected only by filing. Thus, Assignee has priority as to the check under subsection (d) [UCA § 57-26-115(4)].

*Illustration 2.* Same as Illustration 1, except Debtor deposits the check into a deposit account maintained at Bank. Secured Party has not established control over the deposit account in accordance with *U.C.C. § 9-104* [UCA § 70A-9a-104]. Assignee has a perfected security interest in the deposited funds as identifiable cash proceeds of rents. Secured Party also has an Article 9 security interest in the deposited funds as proceeds of the check, but that security interest is perfected only by virtue of Article 9's continuous perfection as to identifiable cash proceeds under *U.C.C. § 9-315(c), (d)(2)* [UCA § 70A-9a-315(3)]. Thus, Assignee has priority as to the deposited funds under subsection (d) [UCA § 57-26-115(4)].

*Illustration 3.* Same as Illustration 2, except that Secured Party has established control over the deposit account by virtue of a control agreement as provided in *U.C.C. § 9-104(a)(2)* [UCA § 70A-9a-104(1)(b)]. Secured Party has priority as to the deposited funds under subsection (d) [UCA § 57-26-115(4)].

*Illustration 4.* Same as Illustration 2, except that Bank attempts to exercise a right of setoff against Debtor after Debtor defaults to Bank in repayment of an unsecured line of credit. Bank's right of set-off has priority over Assignee's security interest in the deposited funds. *Cf. § 9-340(a),(b)* [UCA § 70A-9a-340(1) and (2)] (bank's right of set-off generally not affected by existence of security interest in deposited funds). [See also UCA § 57-26-115(5)].

*Illustration 5.* Same as Illustration 4, but assume that Assignee has achieved control by becoming Bank's customer with respect to the deposit account as described in *U.C.C. § 9-104(a)(3)* [UCA § 70A-9a-104(1)(c)]. Bank's exercise of its set-off right would be ineffective against Assignee. *Cf. U.C.C. § 9-340(c)* [UCA § 70A-9a-340(3)] (exercise of bank's set-off right ineffective against a person holding a security interest in the deposit account who becomes bank's customer with respect to that account). [This illustration is less clear in Utah because the Utah version of the Uniform Act added a new subsection (5) to UCA § 57-26-115 (what was Section 15 of the Uniform Act) which reads: "An assignee's perfected security interest in identifiable cash

proceeds is subordinate to a conflicting interest arising under a right of recoupment or set off.” There is no express exception for a control agreement where the assignee is the bank’s customer. However, perhaps the result is still the same if the UCC and the Act are read together to maintain consistent treatment. This makes sense because the bank’s set off rights against one customer, the assignor, should not affect the account of another customer, the assignee; presumably there simply is no bank right of recoupment or offset to apply to the account of the assignee.]

*Illustration 6.* Assignor makes an assignment of rents to Assignee, and Assignee promptly records. The following month, Assignor receives a rent check from Tenant, and deposits the check into a bank account containing only proceeds of rents. Assignor then writes a check drawn on that bank account to Supplier in payment of an account incurred by Assignor to purchase office equipment and supplies. In good faith, Supplier accepts the check and presents it for payment and the check is paid. Even though Assignee had a perfected security interest in the proceeds of rents deposited into the bank account, Supplier takes the funds paid from the bank account free and clear of the Assignee's security interest in those funds. *Cf. U.C.C. § 9-332(b)* [UCA § 70A-9a-332(2)] (transferee of funds from deposit account takes them free of a security interest in the deposit account unless the transferee acts in collusion with debtor in violating rights of secured party).

*Illustration 7.* Assignor makes an assignment of rents to Assignee, and Assignee promptly records. The following month, Assignor receives cash from Tenant in payment of Tenant's rent obligation. Assignor uses the cash to purchase cleaning equipment from Supplier in an ordinary course transaction. Assignor does not file an Article 9 financing statement covering the cleaning equipment. [Neither does the Assignee.] Even though Assignee had a perfected security interest in the cash collected from Tenant, Supplier took the cash free and clear of the Assignee's security interest. *Cf. U.C.C. § 9-332(a)* [UCA § 70A-9a-332(1)] (transferee of money takes it free of a security interest unless the transferee acts in collusion with debtor in violating rights of secured party). Furthermore, while Assignee may have a security interest in the cleaning equipment as the identifiable noncash proceeds of rents, Assignee's security interest in the cleaning equipment is unperfected under subsection (b) [UCA § 57-26-115(2)], and would be subordinate to any perfected Article 9 security interest in the cleaning equipment. *Cf. U.C.C. § 9-322(a)(2)* [UCA § 70A-9a-322(1)(b)] (perfected security interest has priority over conflicting unperfected security interest).

*Illustration 8.* Same as Illustration 7, but assume Assignee has filed an Article 9 financing statement sufficient to cover all of Assignor's assets. Assignee has a perfected security interest in the cleaning equipment. The priority of that security interest versus other conflicting interests will be governed by the priority rules expressed in Article 9. *Cf. U.C.C. § 9-322(a)(1)* [UCA § 70A-9a-322(1)(a)] (conflicting perfected security interests); *U.C.C. § 9-317(b)* [UCA § 70A-9a-317(2)] (buyers other than in ordinary course).

3. **Lender Options.** A Lender has several options in making a secured loan where rents are to be part of the collateral.

a. Basic Mortgage Provisions. The lender could make the loan secured by a standard mortgage or trust deed. (No well advised professional lender uses a contract for deed.) It can have a specific assignment of rents in it (or in a separate instrument) or rely on the implied assignment under the Act. If a residence is involved, the lender should have an express assignment of rents to keep the enforcement by notification options open to it. For many, even most mortgage loans, this will be sufficient for the lender because the Act provides relatively easy and effective remedies and the lender is mostly looking to the value of the real property for its security.

b. More Complex Loans. If the loan is large or complex, or if a high percentage of the real property value is lent, the lender may want to go further where economically justified.

i. Basic Cash Control. For example, it may want to obtain subordination, non-disturbance and attornment agreements (an “SNDA”) with the tenants. The SNDAs could contain “hell or high water” clauses requiring tenant rent payments to continue despite a landlord default (the tenants typically could separately sue the landlord for damages). The lender may want to have security in the other assets of the borrower, and perfect on those other assets under Article 9 of the UCC (or other applicable method). Among such assets, it may want to obtain security in and perfect against the rent deposit account of the borrower, and require that rents be deposited there. This could be by a UCC filing or by a control agreement.

ii. Stronger Cash Control. It may even want to require the borrower to have the tenants deposit rents in a deposit account of the lender itself so that the lender is the bank’s customer and thus has perfection by control under the UCC with priority over bank off sets and claims against the assignor (a filed UCC-1 Financing Statement may be redundant but it would give notice to third parties). The deposit requirement should be in an agreement with the tenants, such as under the SNDA, or under the lease where the lender is made a third party beneficiary. The rent payments would typically be sent to a postal lockbox controlled by the lender or be sent by wire transfer to the controlled account. The lender would dole out the cash to the borrower to cover budgeted items (including building maintenance, etc.). Lockbox arrangements are generally used for revolving credits.

iii. Other Security Features. The lender will likely want to obtain a security interest in any security interest the tenants provide to the borrower landlord (e.g., deposits, letters of credit, personal or real property, etc.) and have assignments of guarantees by the tenants’ principals or third parties, and so on. Financial covenants and bankruptcy protection provisions in the major leases (as well as from the landlord borrower), may also be desired by the lender. At the time the loan is made, and from time to time afterwards, the lender may want the landlord and the tenant to supply estoppel certificates, financial information, insurance certificates, etc., all to support the expectation of continued rent flows to service the loan obligation.