

Approved

2/18/91

Date

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE

The meeting was called to order by SENATOR RICHARD L. BOND at  
Chairperson

9:00 a.m./~~p.m.~~ on THURSDAY, FEBRUARY 14, 1991 in room 529-S of the Capitol.

All members were present ~~XXXX~~.

Committee staff present:

Bill Wolff, Research Department  
Fred Carman, Revisors Office  
Louise Bobo, Secretary

Conferees appearing before the committee:

Ron Smith, Kansas Bar Association  
Carl Circo, Stinson, Mag and Fizzell, Kansas City  
Jim Maag, Kansas Bankers Association  
Barkley Clark, Shook, Hardy & Bacon, Kansas City (in absentia)  
Carolyn Adams, Bank IV  
Noelle St. Clair, Housing and Credit Counseling, Inc.

Chairman Bond called the meeting to order at 9:12 a.m.

SB 81 - Assignment of rents and other amounts as security for repayment of indebtedness.

Ron Smith, Kansas Bar Association, appeared before the committee briefly to introduce Carl Circo, partner in the law firm of Stinson, Mag and Fizzell, Kansas City. He also advised the committee that Mr. Circo brought this issue to the attention of his Association and that they are in favor of its passage.

Carl Circo explained to the committee that there was uncertainty about the correct rule of law governing a lender's interest in collection of rents in event of a bankruptcy. Mr. Circo added that SB 81 was needed for other reasons: (1) the issue of perfecting a lien from the issue of enforcing one is unclear and, (2) the value of rented commercial property as loan collateral is reduced because the lender cannot be assured of collecting the rents in case of a default. (Attachment 1)

During discussion, one committee member was concerned whether oil and gas royalties were covered under this proposal. Mr. Circo replied that he was unclear on this point and would have to study this matter further. Another member questioned if the bill would be retroactive. Mr. Circo said that it would be up to the courts to decide, however, his thinking would be that SB 81 is more a clarification of the law rather than a change in it; therefore, would not be retroactive. Mr. Circo was also asked if rents from mobile homes and apartments on upper floors would be included in this bill. Mr. Circo replied that if the mobile home was attached to the land, then it would be considered real estate and thus subject to this law, as would upper floor apartments.

Jim Maag, Kansas Bankers Association, informed the committee that his organization agreed with the Kansas Bar Association that it was imperative to clarify the issue of what constitutes perfection in assignment of rents. (Attachment 2)

Mr. Maag also passed out to the committee written testimony of Barkley Clark, Attorney with Shook, Hardy & Bacon, Kansas City. Mr. Clark's comments are in accord with Mr. Circo and he strongly favors its passage. Mr. Clark's only suggestion was to change the effective date from publication in the statute book to publication in the State Register. (Attachment 3)

Carolyn Adams, Bank IV General Counsel, was introduced to the committee by Mr. Maag. She strongly urged passage of this proposed legislation as it does address a number of problem areas; however, Ms. Adams said that she was concerned about several things including, (1) the effect of SB 81 on prior filings, (2) the implication that only

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE,

room 529-S, Statehouse, at 9:00 a.m./~~p.m.~~ on THURSDAY, FEBRUARY 14, 1991.

judicial remedies are acceptable, and (3) the difficulty of a lien search under this bill. Ms. Adams concluded by stating that her company, despite these concerns, urges adoption of SB 81, recognizing that if a lender cannot depend on an assignment of rents as collateral, the availability of financing to landlords will be limited. (Attachment 4)

Noelle St. Clair, Housing and Credit Counseling, Inc., addressed the committee concerning this proposal. Ms. St. Clair advised that the members of her organization had conflicting views on how this bill affects the rights of tenants occupying the premises. She further added that they found the language of the bill to be very confusing and nothing in the bill that would or would not indicate consumers occupying rental property would know that their rights are protected. She urged the committee to take a close look at SB 81 and make sure it protects the rights of all Kansas citizens. (Attachment 5)

There being no further conferees, Chairman Bond announced the hearing closed. He summarized the committee's intentions by stating this issue needs to be addressed but the bill also needs certain amendments. The consensus of the committee seemed to be that, (1) the question of oil and gas leases and royalties needs to be considered, (2) the language in the bill needs to be changed so as not to eliminate self-help, and (3) the language concerning the appointment of a receiver needs to be clarified. The Chairman requested Mr. Smith, Mr. Maag, Mr. Carman, and Ms. Adams to work out the suggested amendments and, hopefully, the committee will be able to work the bill on Tuesday, February 19.

Minutes of Wednesday, February 13, 1991, were approved as written on a motion by Senator Reilly with Senator Salisbury seconding the motion. The motion carried.

The meeting adjourned at 9:56 a.m.



PROPOSAL FOR LEGISLATION ON PERFECTING  
ASSIGNMENTS OF RENTS IN KANSAS

In commercial real estate loans, borrowers commonly assign the lenders the rents earned from the real estate as part of a mortgage or by a separate instrument, creating a lien on the rents as collateral for the debt. Under Kansas law, like in many other states, the lender is not entitled to collect the rents until it has taken possession or control of them by legal action, such as having a receiver appointed, or by additional agreement with the borrower.

Under the Bankruptcy Code, if a lien is not "perfected" at the time the debtor files a bankruptcy petition, it may be avoided by the debtor in possession or bankruptcy trustee. Recently, some of the bankruptcy courts that have considered the issue, including ones in Kansas, have held that the lender's lien under an assignment of rents is not perfected until the lender has taken the necessary action to acquire possession and control of the rents. If the borrower files for bankruptcy before the lender takes the necessary action, these courts hold, the lender loses its interest in the rents. However, other bankruptcy courts, again including ones in Kansas, have come to the opposite conclusion, resulting in uncertainty about the correct rule of law.

This is a troublesome situation for two other reasons. First, these decisions fail to distinguish the issue of perfecting a lien from the issue of enforcing one. As a result, these decisions defeat one purpose of the real estate recording laws. Under those laws, the lien of a mortgage on land is perfected from the time the mortgage is properly recorded, even though the mortgagee must still file a foreclosure suit to enforce that lien. There is no reason why the lien of an assignment of rents should be treated differently. Failing to treat an assignment of rents as perfected upon recording judicially excludes such instruments from the coverage of the recording laws even though they affect an interest in real estate and serve the same purpose as real estate mortgages.

Second, as an economic matter, the value of rented commercial property as loan collateral is reduced because the lender cannot be assured that it can collect the rents if the loan goes into default.

To resolve such problems, some states have recently passed laws addressing the issue. Kansas should do so also. To that end, the attached statute is proposed.

Marvin Rau  
Carl Circo  
Overland Park, Kansas

*Attachment 1  
F I T I  
2/14/91*



The KANSAS BANKERS ASSOCIATION  
A Full Service Banking Association

February 14, 1991

TO: Senate Committee on Financial Institutions and Insurance  
RE: **SB 81** - Perfecting assignments of rents as security for loans

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to appear in support of **SB 81**. The need to clarify Kansas law relating to the perfecting of assignment of rents when used as debt collateral is one which has been recognized by both the legal profession and the banking industry. That is why the Kansas Bankers Association appears today with the Kansas Bar Association as a co-sponsor of **SB 81**.

Until the issue of what constitutes perfection in this area has been resolved it greatly diminishes the value of rented commercial property as loan collateral. In these difficult times, when commercial banks desire to expand their commercial lending, but are also well aware of the need to make sound loans which will meet regulatory guidelines, it is extremely important that conflicting judicial interpretations on issues of this nature be resolved by the Legislature as soon as possible.

We do not believe a lien on an assignment of rents should be treated any differently than a lien of a mortgage on land. The latter is perfected at the time the mortgage is recorded. When assignments of rents is not treated in the same manner it excludes such assignments from being covered by the recording laws even though they serve the same purpose as real estate mortgages.

For the sake of resolving the current judicial confusion and creating a more positive lending climate for commercial real estate in Kansas, we would strongly urge the committee to give favorable consideration to **SB 81**.

A handwritten signature in black ink that reads 'James S. Maag'.

James S. Maag  
Senior Vice President

*Attachment 2  
FI + I  
2/14/91*

LAW OFFICES

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February 11, 1991

Senator Dick Bond  
 Committee on Financial Institutions  
 and Insurance  
 KANSAS STATE SENATE  
 State Capital Building  
 Topeka, Kansas

Re: Senate Bill No. 81

Dear Senator Bond:

Based upon my interest in Kansas commercial law and legislative initiatives in this area, I have carefully reviewed Senate Bill No. 81 which I understand has been introduced as a bill from your committee. I strongly support the enactment of this bill. It will close a loophole that has created great uncertainty.

The problem addressed by the bill is the attack, primarily in bankruptcy courts, upon rent assignments that have been taken as collateral security for loans. In the typical commercial loan to a landlord, the secured lender takes a mortgage on the real estate, together with an assignment of leases and rentals. From an economic point of view, the assignment of rentals is the most important element of the loan because that is the asset that creates a stream of payments and thus generates liquidity for borrower and lender alike. It has always seemed to me that such a loan should be insulated from attack by a trustee in bankruptcy if the real estate mortgage, together with the assignment of rents and leases, was properly perfected under Kansas real estate law. (It is clear that there is no necessity to perfect under Article 9 of the Uniform Commercial Code, based upon the plain language of K.S.A. § 84-9-104(j)). Such a recording provides perfectly adequate constructive notice to all third parties dealing with the borrower. In spite of this situation, a number of bankruptcy trustees are arguing that the lien on an assignment of rents is not perfected until the lender has taken possession or control of the rents by a post-default legal action, such as appointment of a receiver. The courts are reaching these decisions on the basis of Kansas real estate law. Some courts properly conclude that the lender's interest is fully perfected in the rents upon recordation of the mortgage and assignment, but others come to the opposite conclusion. The result is great uncertainty under Kansas law as to the perfected status

*Attachment 3*  
*F + F*  
*2/14/91*

Senator Dick Bond  
February 11, 1991  
Page 2

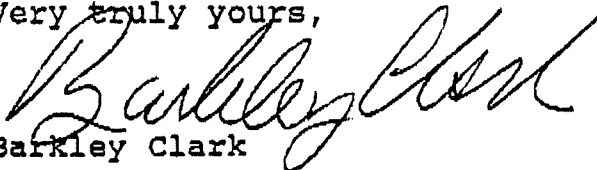
**SHOOK, HARDY & BACON**

of a real estate loan made to a lessor. This uncertainty undercuts the value of commercial real estate as loan collateral because the lender is never certain whether its lien will stand up in bankruptcy.

It seems to me that Senate Bill No. 81 nicely clears these muddy waters by providing that a recorded assignment instrument assures a perfected lien on the stream of payments coming from the various lessees. I thought this would have been the result anyway under K.S.A. § 58-2221, but the adverse judicial decisions make this legislative clarification necessary. I also like the fact that the bill clarifies the right of the secured lender, upon the borrower's default, to apply to the district court for a receiver or other appropriate relief to gain possession and control of the rents and enforcement of the assignment instrument. My only complaint with the bill is that its effective date, under § 2, is publication in the statute book, i.e. July 1, 1991. It seems to me that it would be preferable to accelerate the effective date, to publication in the State Register.

This is good legislation. I can't imagine why any person involved in commercial lending or borrowing would be against it. The certainty it brings to Kansas law helps borrowers and lenders alike. Please let me know if you have any further questions about Senate Bill No. 81.

Very truly yours,



Barkley Clark

BC:ved

TESTIMONY

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS AND INSURANCE

Mr. Chairman and members of the Committee, my name is Carolyn A. Adams, Vice President and General Counsel, BANK IV Topeka, N.A. I very much appreciate the opportunity to discuss the issue of liens granted by an assignment of rents as it is addressed in Senate Bill 81.

Given the nature of the very serious matters the legislature has to consider this year, SB81 may seem insignificant. But it is very important to the parties it would protect because it affects availability of financing.

BANK IV Topeka, N.A. is a \$635MM bank which offers a full range of loans. Much of my legal work for the bank is loan documentation. Some of the loans are secured by assignments of rents from real estate, such as an office building, apartment house, a shopping center, or even a private residence.

Background. Finding financing is essential to the success of any project, whether it is a new construction loan, a "take out loan" for permanent financing, or a working capital loan for an existing building or complex of buildings. The landlord in need of financing may be an individual, a partnership or a corporation. In today's economy, the borrower could even be a family unable to sell their home.

The financing may be complex, and there are many variations to the arrangements. The collateral for such a loan may include a mortgage, but the mortgage loan may be with a different lender, or there may be no mortgage on the property. The rents may be from sub-leases on leased property. The rents might be from one major tenant or many different tenants. The assignment of rents may be outright (meaning all rents are paid to the lender) or contingent (meaning they are paid to the lender after default on the loan).

Problems. There are two general areas of problems with rents as collateral. One is the practical side of getting control of the rent payments when necessary. The other is the legal aspect of having the right to the payments.

The legal aspects are subdivided into two parts - legal rights between the lender and the borrower, and legal rights as to third parties. Most of the problems are challenges of third parties in the bankruptcy courts where issues are complex and relate to perfection, priority, preferences and cash collateral questions.

For example, the creditor of a bankrupt landlord has the right to adequate protection for cash collateral only if the collateral is perfected and not a preference. In several cases, the court has emphasized that Kansas has no law for perfecting assignments of rents.

Rents are somewhat unique in character because they are considered profits from real estate, yet have sometimes been characterized as personal property (see footnote at end).

Proposed Legislation. At first glance, SB81 seems to address all of the problem areas. SB81 acknowledges that an assignment instrument creates a lien, specifies the method of perfection as filing in the local real estate records, and makes clear that future leases and rents can be included. The bill makes clear that the lien is valid against third parties and is effective from the time of filing. It provides for judicial remedies including appointing a receiver without initiating foreclosure. It also makes clear that Kansas has state law acknowledging the lender's rights.

*Attachment 4  
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2/14/91*



Intent. The legislative intent of any new law is important. Hopefully, the legislative intent is to cure the problems addressed herein.

Concerns. In reviewing this bill with other counsel, we have the following concerns:

1. The effect of SB81 on prior filings is ambiguous.
2. Only judicial remedies are provided. Any implication that contractually agreed self-help remedies are not available should be avoided.
3. SB81 does not expressly protect the tenant that pays rent to the lender upon notice from the lender pursuant to the respective assignment contract.
4. It does not address the priority or subordination of statutory lien creditors who file a subsequent lien with "relation back" provisions.
5. A lien search would be difficult under SB81. An assignment instrument can be in any "mortgage, deed of trust, real property security instrument or other instrument or agreement". Thus, it will be necessary to review all such filings to determine if a prior instrument contains such language.

Conclusion. Due to recent bankruptcy decisions, there is a great deal of concern among lenders about relying on an assignment of rents as collateral. If the lender cannot rely on these assignments, the availability of financing to landlords will be limited. Therefore, I urge the Legislature to adopt SB81.

Thank you very much for this opportunity to speak to you, I would be happy to try to answer any questions.

\* \* \*

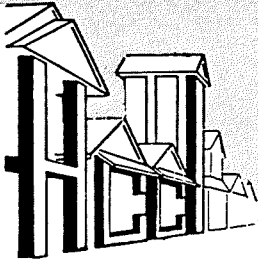
Footnote. An Assignment of Rents as collateral has been a gray area of the law in regard to perfection of such an assignment. It is extremely complex.

The Uniform Commercial Code contains two exceptions which seem to conflict. K.S.A. 84-9-104 states that the UCC does not apply to the creation of an interest in real estate, including a lease or rents thereunder. But K.S.A. 84-9-102 (3) states that the UCC applies to a security interest despite the fact that there is collateral to which the UCC does not apply.

This apparent conflict is confusing to lenders, attorneys and the courts - especially the bankruptcy courts. This is further complicated by the definition of the "general intangible" category. It is a catch-all for contract rights that do not fit in another category. Without the exception in K.S.A 84-9-104, an assignment of rents might be treated as a general intangible.

Most case law interpretations involve five general issues:

1. Granting a lien or security interest;
2. Method of perfection;
3. Effect on after-acquired rents or leases;
4. Lender's duty to take action to control or possession of rents; and
5. Impact on third parties, such as tenants, statutory lienors and other special parties.



# Housing & Credit Counseling Inc

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Testimony  
To  
Financial Institutions and Insurance Committee  
On  
Senate Bill 81  
By  
Noelle St.Clair  
Housing & Credit Counseling Inc.

February 14, 1991

Mr. Chairman and members of the committee.

I appreciate the opportunity to meet with you today and point out some information that you may want to take into consideration as you work Senate Bill 81. Before I do that I would like to explain a little bit about our agency.

Housing and Credit Counseling Inc. is a Topeka based non profit agency with the purpose of facilitating safe, adequate, affordable and equitable housing situations for all people and to assist people in preventing or resolving temporary financial difficulties through our Consumer Credit Counseling Service.

Our Consumer Credit Counseling Service is an integrated money management program composed of mortgage default and rent delinquency counseling, budgeting, credit counseling and intervention, and counseling regarding home ownership, and consumer advice.

Our Housing Service assist both landlords and tenants who have specific questions and circumstances they need help with. Our counselors inform clients of their options and help to facilitate resolutions to their specific housing concerns.

We in no way profess to be experts in Bankruptcy law or Commercial Real Estate loans or are we speaking out for or against Senate Bill 81. We also want you to know that in researching this bill we received conflicting points of view about whether this bill would or would not affect the rights of consumers (tenants) occupying the premises .



HUD Comprehensive  
Counseling Agency



Consumer Credit  
Counseling Service



United Way  
of Greater Topeka

*Attachment 5  
FI + I 2/14/91*

Our agency frequently hears from tenants who live in units that are owned by someone who is, or who has filed bankruptcy and is in some stage of the foreclosure process.

Often times the tenant is not given notice that anything is happening to the property and come home and find a letter stating they have to pay the rent to some lender, or have to vacate the premises in a short amount of time.

Under the Kansas Residential Landlord Tenant Act tenants have certain rights some of which are:

- Notice of change regarding the terms of their lease agreement .
- Proper maintenance of their unit.
- Proper notice to quit.
- Notice of who they should contact to take care of any problem, emergency.
- Notice of who they should pay the rent to.

In our review of Senate Bill 81 we found the language of the bill to be very confusing and found nothing that would or would not indicate that consumers occupying rental property would know that their rights are protected even though action had been taken by a lender to protect its interest.

It is our hope that by bringing to light these concerns the Financial Institutions and Insurance Committee will look closely at Senate Bill 81 and make sure that it protects the rights of all Kansas citizens.