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BERGMAN ON MORTGAGE FORECLOSURES . . .

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Assignment of Rents—What's It Worth?*

Although an assignment of rents clause is common to almost any reasonably well-drafted mortgage, its uses and limitations may not be so widely understood, which lends value to the musings here. First, the clause will have utility as a weapon only where the property produces income. The minimal or threshold example would be a two-family house. Obviously more fertile is a four- or six-family dwelling, or an apartment building or shopping center.

Assuming there is income to capture, there are three related concepts to compare: mortgagee in possession, receivership and assignment of rents. The receivership is obviously the most common, and with good reason. The receiver is an independent party (usually an attorney) appointed by the court (upon application) who is authorized to collect the rents, issues and profits of the mortgaged premises. Not incidentally, the receiver also protects and preserves the property, making repairs when necessary. At the end of the foreclosure, the net funds collected are applied in reduction of the mortgage debt. A corollary benefit is that the receiver cuts off any income stream from the property to the borrower, thus diminishing the will (and the funds) to interminably delay the case. Also, the receiver must post a bond to provide recourse if he fails to discharge his duties or performs them negligently.

Less utilitarian is becoming a mortgagee in possession. In essence, (although there is more to this) the mortgagee itself can become a substitute for a receiver and take control of the premises. An immediately recognizable problem with that is liability—to say nothing of having qualified staff to oversee the task. Insurance helps, but the lender itself becomes responsible for repairs, any waste that occurs, accidents at the premises and the like. Not surprisingly, lenders would usually prefer the insulation of a receiver.

Finally, we come to the assignment of rents, the foundation of this review. The heart of the usual mortgage clause is the assignment of rents at the premises to the lender, but triggered only upon default. Whether this assignment is automatic upon default or requires an affirmative demand by the lender depends upon the wording of the provision.

Assuming a lender wishes to avail itself of this remedy, as a practical matter a writing would be conveyed to the borrower exercising the assignment. Then letters would go to the various tenants demanding that rents be paid directly to the lender.

But if concepts surrounding assignments of rents are somewhat obscure among professionals, one can imagine how perplexed tenants would be when told to pay rent to someone other than their landlord. When, as they almost invariably will, tenants inquire of the landlord (borrower), the response will be to ignore the demand from the lender and continue paying rent in the normal course.

Experience suggests that while some very few tenants *will* pay the lender, most will simply seize the opportunity to pay no one. What, then, does the lender do? The answer leads to the ultimate shortcoming of the assignment of rents provision. The lender could initiate a suit against each tenant to collect rents becoming due from the date of demand. Even if the tenants then pay, future defaults will require future suits. More disconcertingly, the cost of these actions would be disproportionately high given the amount at issue. Militating most strongly against using the assignment of rents: a summary proceeding cannot be employed—that is, eviction is not a remedy![1] The assignee is simply not a landlord and, as an agent, has no right to possession. This remains so even if the assignment of rents clause also contains an assignment of lease aspect.[2]

To glean the benefit of proceeding with the assignment of rents invites a return to the receivership. A receiver is empowered to collect all rents due at the time of his appointment. When a plaintiff elects to pursue a receivership, while in special cases it can be obtained in a matter of days, sometimes it can take weeks. If a lender *first* exercises the assignment of rents, should the tenants react in the usual fashion by ceasing rent payments to anyone, there will be that much more rent "due," which the receiver can collect rather than the defaulting borrower!

So, limited though its utility may be, there is a role for the assignment of rents in some cases.

Endnotes

1. Suderov v. Ogle, 149 Misc.2d 906, 574 N.Y.S.2d 249 (App. Term 1991), citing, *inter alia*, Poughkeepsie Sav. Bank v. Sloane Mfg. Co., 84 A.D.2d 212, 445 N.Y.S.2d 560.
2. Suderov v. Ogle, *supra.*, citing Mooney v. Byrne, 163 N.Y. 86, 57 N.E. 163; Carr v. Carr, 52 N.Y. 251.

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