

## **A Bank's Entitlement to Rents upon Default**

By Camille J. Iurillo and Gina M. Pellegrino

Scenario: Suppose a borrower obtains a loan from a lender, executing a promissory note, mortgage and assignment of rents. The borrower subsequently defaults on the loan. The lender files a lawsuit against the borrower alleging that the borrower defaulted on the promissory note. The lender also makes written demand to the borrower for turnover of all rents, pursuant to the assignment of rents. Thereafter, the lender files a motion to require the rents to be deposited into the court registry. The borrower is utilizing the rents to continue operating and maintaining the property. If the rents are deposited with the court, the value of the property will arguably substantially decrease, as the property will no longer be properly cared for. In such instance, will the court automatically order that the borrower deposit all of the rents into the court registry? Not necessarily.

According to the assignment of rents statute, Fla. Stat. § 697.07(4), “[u]pon application by the mortgagee or mortgagor, in a foreclosure action, and notwithstanding any asserted defenses or counterclaims of the mortgagor, a court of competent jurisdiction, pending final adjudication of any action, may require the mortgagor to deposit the collected rents into the registry of the court, or in such other depository as the court may designate. However, the court may authorize the use of the collected rents, before deposit into the registry of the court or other depository, to: (a) [p]lay the reasonable expenses solely to protect, preserve, and operate the real property, including without limitation, real estate taxes and insurance; (b) [e]scrow sums required by the mortgagee or separate assignment of rents instrument; and (c) [m]ake payments to the mortgagee.”

Moreover, according to the applicable case law, Fla. Stat. § 697.07 was not written to create an “absolute transfer of ownership interest in rents where none existed before;” rather, it was “intended to be nothing more than additional security.” *In re One Fourth Street North, Ltd.*, 103 B.R. 320, 321 (Bankr. M.D. Fla. 1989) (*authorizing the Debtor to use the rents, as cash collateral, to maintain the property and pay its ordinary operating expenses, which includes ordinary maintenance and tenant service*). The Court explained in *Fourth Street North*, “if the mortgagee had acquired an ownership right in the rents upon making the written demand, there would be no further need of any proceeding or an adjudication of the mortgagee’s right to the rents, and the statute contemplates some further adjudication or determination of the mortgagee’s right to the rents.” *Id.* at 321-2. The Court reasoned further “section 697.07 on its face provides that the rent proceeds shall be utilized to protect the mortgaged property. This proposition is consistent with the notion only of a security interest in the rents, and not absolute ownership interest. To accept the proposition that a written demand for the rents by the mortgagee, pursuant to the statute, confers absolute ownership would also mean that even if the underlying obligation owed to the mortgagee is satisfied, the mortgagee would still be entitled to collect the rents even though there is nothing further owed by the mortgagor, a proposition which is absurd on its face.” *Id.* at 322.

It appears that the intention of the assignment of rents statute is to preserve the rents until the parties' claims to the rents can be determined by the court. Therefore, upon the lender's demand for the rents from the borrower, the court may require that the borrower deposit the rents

into a designated account pending final adjudication of the action; alternatively, the court may permit the borrower to pay expenses associated with the property. *See, In re Venice-Oxford Assocs. Ltd. Partnership*, 236 B.R. 791, 799 (Bankr. M.D. Fla. 1998).

Therefore, whether you represent a borrower or a lender, keep in mind that even if the borrower executed an assignment of rents, upon the borrower's default on the loan with the lender, the court will not necessarily require that all of the rents be turned over to the lender or placed into the court registry.

**Iurillo & Associates, P.A.**, located in downtown St. Petersburg, is comprised of **Camille J. Iurillo**, Shareholder, **Gina M. Pellegrino**, Associate, and **Sabrina C. Beavens**, Associate. The primary areas of practice of **Iurillo & Associates, P.A.** are Commercial and Bankruptcy Litigation, Debtors' and Creditors' Rights, and Foreclosures/Workouts.