

Landlord's Liens

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“A promise must never be broken”

– Alexander Hamilton

When a landlord signs a commercial lease, they expect the tenant to keep their promise: pay the rent - on time and in full. As we know, it's never that easy. When tenants break this promise, landlords and property managers have to scramble to recover their losses. Often, the security deposit is not enough to cover the amount owed, and if the tenant is destitute, then lawsuits are fruitless. Another option is to go after the tenant's personal property in the Premises. If it has any value, a landlord may use it for a replacement tenant or sell it. However, the landlord must first determine if it has a valid first lien on any of the tenant's personal property in the premises. There are two kinds of liens available to a commercial landlord: a contractual lien and a statutory lien per the Texas Property Code. This article will discuss how to perfect a contractual lien, the differences between the two liens and typical issues related to landlord's liens.

The Contractual Lien. A typical commercial lease provides for a security agreement where the tenant grants the landlord a contractual lien on its personal property in the premises. Article 9 of the Uniform Commercial Code governs these contractual liens. While the lease acts as the security agreement creating a landlord's lien, the lien must be “perfected” by filing a financing statement, which is commonly called a “UCC-1”. Perfecting the lien puts the world on notice that the landlord claims a lien on the tenant's property described in the UCC-1. The security agreement (i.e. the landlord lien section of the lease) describes the specific property subject to the lien. This description of the property in the lease should be the exact description on the UCC-1. Once the lease containing the security agreement is signed, and the UCC-1 is filed, the contractual lien is perfected. You typically file the UCC-1 with the Secretary of State's office of the state where the tenant entity was formed, and, for good measure, the state in which the premises is located. However, if the lien applies to tenant's fixtures or any real property, the UCC-1 should also be filed in the county clerk's office where the premises' is located.

The Statutory Lien. Under the Texas Property Code, a commercial landlord has a preference lien on all the tenant's property in the premises to secure the certain past and future rent due. The lien arises as a matter of law and there the landlord does not have to file a UCC-1 or put any special language in the lease. The Texas statutory lien gives the landlord a preference lien for rents accruing during each lease year. This has been interpreted to grant priority to a landlord's lien over a competing UCC lien where the UCC lien was perfected after the beginning of the lease date or anniversary date, but it only has this priority for the first year of the lease. For example, if the lease term commences on January 1, 2019, and a third-party creditor files a UCC-1 on February 1, 2019 covering property in the premises, and if tenant defaults prior to January 1, 2020, the statutory landlord's lien prevails. However, if the default occurs during the second year of the lease, then the statutory landlord lien is inferior (second-in-line) to the other creditor's UCC lien. A statutory lien is valid for 30 days after a tenant vacates the premises and to preserve it, a lawsuit must be filed within such 30-day period.

The statutory lien is limited to the rent due during the current twelve-month period succeeding the date of the lease, or an anniversary of that date. In addition, the lien is enforceable for rents that are up to six months past due. If rent for a commercial property becomes more than six months past due, the lien is unenforceable unless the landlord files a verified lien statement with the county clerk where the property is located stating: (i) the amount due; (ii) the months in which rent is claimed; (iii) tenant's name and

address; (iv) a description of the premises; and (v) the commencement and termination dates. Unlike a contractual lien, a statutory lien must be foreclosed by filing a lawsuit seeking collection of the defaulted rent and foreclosure of the statutory lien.

Lien Waivers/Subordinations. Oftentimes, your tenant's lenders will request that the landlord subordinate or waive its landlord's lien. Before you agree to this, you need to analyze the impact. For example, if you were relying on the value of the tenant's personal property in order to mitigate damages upon a tenant default, then you may need to ask the tenant for additional security deposit or a letter of credit. Further, many lenders will want to camp out in the premises for a protected period of time while they utilize the collateral, or otherwise try to sell it. A landlord must also be mindful of the tenant's lender damaging the premises by tearing out the collateral.

Priority of Contractual Liens. A tenant may have other secured creditors. If that is the case, the date the landlord's lien is perfected establishes priority of its liens. The earlier filed UCC-1 takes priority over the subsequently filed UCC-1s. Financing statements are good for five years from the date the UCC-1 financing statement is filed. In order to retain its perfected priority, the landlord must file a continuation statement, called a UCC-3, in the same places the original UCC-1(s) was filed, within six months prior to the expiration of the five year period. Failure to file a continuation statement before the expiration of the five-year period will result in loss of the landlord's perfected status and basically loss of the lien if the tenant has other secured creditor.

Key Issues in Completing the UCC-1. Completing the UCC-1 accurately is extremely important – the simple misspelling, or listing a tenant's trade name rather than the correct legal name, may invalidate a filing if it is seriously misleading to the public. A landlord must be careful to identify the tenant properly on each UCC-1. For individuals, the correct, full legal name should be used. If the individual goes by another name, include the "also known" name (a/k/a). For married couples, include both parties' legal names. Do not use "Mr. and Mrs." If the tenant is an entity, use the correct legal name as it is filed with the secretary of state. Be sure to use the full legal name, identify the type of organization, and identify the state of organization. If the entity conducts business under a d/b/a, list that information as well, although, legally, it is not always necessary. Make sure to include the address of the leased premises in the description of collateral or a legal description.

If There is a Default. If there is a competing lienholder, then the priority of its lien versus the landlord's lien will be determined generally in favor of the party who filed first. Thus, each priority question must be evaluated separately and on a case-by-case basis. Therefore, before any action can be taken against the tenant's collateral, the landlord must:

- Take inventory of all personal property in the leased premises. You need to decide if the collateral's value outweighs the effort and cost of trying to sell it;
- Conduct a UCC search at the Secretary of State's office in Texas, the state where the tenant entity was formed, and at the county clerk's office to determine any competing liens;
- If a competing lien is located, its priority must be determined;
- The competing lienholder must be contacted;
- Determine if the tenant filed bankruptcy. If so, the bankruptcy rules may require all creditors (including the landlord) to cease all collection efforts. At that point, the landlord will have to pursue the claim in bankruptcy.
- If a third party has a higher priority on certain collateral than the landlord, that party may be entitled to remove their personal property. Be sure to monitor this carefully so that party only removes what they are legally entitled to remove, and have them sign an appropriate indemnification agreement.
- After notifying all secured creditors and after all third-party personal property has been claimed and indemnification agreements executed, notices should be sent to secured parties and any other party that may be interested in the personal property (for example, the IRS or the State of Texas if there are any tax liens on the tenant).

Foreclosing a Contractual Lien. The initial step is to determine what property is covered under the lien. Does the tenant own the property? Is it leased? Is it a capital lease versus an operating lease? These are difficult questions and counsel should be consulted on them. Once the issues of what property is subject to the lien and the conflicting priorities of lien claimants have been determined, a sale of the goods may be held, but only under the specific rules. The UCC allows the landlord to sell, lease or otherwise dispose of any or all of the collateral by public or private sale, as long as every aspect of the sale or disposition, including the method, manner, time, place and terms are “commercially reasonable”. Further, there must be notice given to the tenant and any guarantor or other person whom the landlord will attempt to hold responsible under the lease. Depending on whether the sale is to be public or private, the notice must state the date, time and place of sale and whether or not the sale will be a public or private sale. It is imperative that proper notice be given since the failure to give proper notice may result in a complete discharge of liability under the lease.

Therefore, it is appropriate that the Notice of Sale be drafted for each public or private sale under the landlord's contractual landlord's lien and due care must be given to the choice of sale as between public and private. Actually, the UCC favors a private sale under most circumstances, since a private sale will generally bring more money than a public sale or auction. In any event, the landlord must be careful to ensure that the sale is conducted in a commercially reasonable manner.

Conclusion. Proper use of any landlord's lien starts before the lease is signed. Many landlords wait until after the tenant defaults before they examine their lien rights. At that point, it may be too late if you don't have the proper lease language or if you have not properly perfected your lien. It is also important to monitor your tenants to spot any warning signs. If you suspect a tenant may be in financial trouble, then start examining your lien rights immediately.