



# The Secured Landlord: Creating a Security Interest in Tenant's Property

By James F. Morrison

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Unlike in other states, Minnesota landlords do not enjoy a statutory right to levy upon the property of a defaulting tenant. Further, distress (a common law right of a landlord to seize a tenant's property to satisfy unpaid rent) has been abolished in Minnesota, even if otherwise agreed upon in the lease.<sup>1</sup> In order to obtain a lien on tenant's property, a Minnesota landlord needs to create a security interest in the tenant's property pursuant to the Uniform Commercial Code ("UCC") set forth in Minnesota Statutes Chapter 336. The following elements are required in order for a valid UCC security interest to be created<sup>2</sup>:

1. There must be express wording in the lease creating a security interest and describing the collateral<sup>3</sup>.
2. The description of the collateral should reasonably identify the collateral to ensure that it encompasses all of the tenant's property, including any collateral acquired by the tenant during the lease term<sup>4</sup>.
3. The security interest must attach, which occurs when the tenant: (i) signs the security agreement (i.e., the lease); (ii) gives value (i.e., signs the lease); and (iii) has rights in the collateral or the power to transfer rights in the collateral to the landlord<sup>5</sup>.

Even if a tenant signs a lease satisfying the above requirements, the landlord's security interest will not have priority over security interests previously granted by the tenant unless the landlord properly perfects a purchase money security interest under the UCC. The landlord must perfect its security interest by filing a financing statement with the proper filing office. If the landlord fails to do so, then its security interest will be subordinate to the security interest of a creditor whose security interest has been perfected<sup>6</sup>. The UCC allows a landlord to file a financing statement without a tenant's signature, provided a tenant has "authorized" the filing by signing the lease in which the security interest is granted<sup>7</sup>. Once its security interest is perfected, the landlord must file continuations of the financing statement prior to its expiration<sup>8</sup>. When the tenant's lease obligations terminate, the landlord should file a termination statement terminating the security interest.

In order to determine if there are prior security interests in the collateral, the landlord should conduct a UCC search with the appropriate office<sup>9</sup>. If the tenant has granted prior security interests in the collateral, the landlord will need to request that the tenant obtain a subordination of those interests in order for the landlord's security interest to obtain priority over those interests.

If a landlord is advancing significant funds for tenant property or improvements, it may want to specify in the lease that the security interest constitutes a purchase money security interest. A purchase money security interest creates a first priority interest in the collateral, even if there are prior security interests in place<sup>10</sup>.

From a practical perspective, it is important to answer the following questions early in the lease negotiation process:

1. Does the landlord want to obtain a security interest in all, or some, of the tenant's property? (Particularly for small space tenants, pushing for a landlord security interest may be detrimental to getting the deal done.)
2. Will the security interest constitute a purchase money security interest?
3. Is the landlord willing to subordinate its security interest to any interest of the tenant's lenders?

Once the above questions are answered, the parties may determine whether a landlord security interest is appropriate.

1. Minn. Stat. § 504B.101

2. The provisions contained in: (i) Minn. Stat. § 336.9-203 regarding attachment and enforceability of security interests; (ii) §§ 336.9-308, et. seq. regarding perfection of security interests, and (iii) §§ 336.9-317, et. seq. regarding priority, as well as other provisions of the UCC need to be followed to ensure the validity and enforceability of security interests.

3. Minn. Stat. § 336.9-203 (b)(3)(A)

4. Minn. Stat. § 336.9-108

5. Minn. Stat. § 336.9-203(b)

6. Effective July 1, 2013, all UCC forms changed. A 30 day grace period is allowed through July 31, 2013, during which both the old and new forms will be accepted by the Minnesota secretary of state. Beginning August 1, 2013, only the new forms will be accepted

7. Minn. Stat. § 336.9-509(b)

8. Financing statements filed with the Minnesota secretary of state are valid for a period of 5 years and expire thereafter, unless a continuation is filed.

9. UCC searches should be conducted with the Minnesota secretary of state for personal property and with the appropriate county recorder/registrar of titles for fixture filings.

10. Minn. Stat. § 336.9-103(b) as to the description of a purchase money security interest and Minn. Stat. § 336.9-324 as to the priority of a purchase money security interest.